No. 87-984-ASX
Status: GRANTED

Title: Shell Oil Company, Appellant
v.
Iowa Department of Revenue

Docketed:
December 15, 1987

Court: Supreme Court of Iowa

Counsel for appellant: Geller,Kenneth S.

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Note: Notice of appeal filed 11/23/87

Entry	Date	Note	Proceedings and Orders
1	Dec 15 1987	G	Statement as to jurisdiction filed.
2	Jan 8 1988		Motion of appellee Iowa Dept. of Revenue to dismiss or affirm filed.
3	Jan 13 1988		DISTRIBUTED. February 19, 1988
4	Jan 14 1988	X	Brief amicus curiae of United States filed.
5	Jan 25 1988	X	Reply brief of appellant Shell Oil Co. filed.
6	Feb 22 1988		PROBABLE JURISDICTION NOTED.
			**********
8	Mar 23 1988		Order extending time to file brief of appellant on the merits until April 21, 1988.
9	Apr 21 1988		Joint appendix filed.
10	Apr 21 1988		Brief of appellant Shell Oil Co. filed.
20	May 6 1988	G	Motion of the Solicitor General for leave to participate in oral argument as amicus curiae and for divided argument filed.
12	May 9 1988		Order extending time to file brief of appellee on the merits until June 4, 1988.
13	May 13 1988		Record filed.
		*	Certified copy of original record, box, received.
14	Jun 2 1988		Brief amicus curiae of California filed.
15	Jun 3 1988		Brief amici curiae of New Jersey, et al. filed.
16	Jun 3 1988		Brief amicus curiae of Multistate Tax Commission filed.
17	Jun 3 1988		Brief amicus curiae of Dept. of Revenue of Florida filed.
18	Jun 3 1988		Brief amicus curiae of United States filed.
19	Jun 3 1988		Brief of appellee Iowa Dept. of Revenue filed.
21	Jun 6 1988		Lodging received.
22	Jun 20 1988		Motion of the Solicitor General for leave to participate in oral argument as amicus curiae and for divided argument GRANTED.
23	Jun 23 1988		CIRCULATED.
24	Jul 1 1988	X	Reply brief of appellant Shell Oil Co. filed.
25	Jul 15 1988		Set for argument. Tuesday, October 4, 1988. (2nd case) (1 hr.)
26	Oct 4 1988		ARGUED.

87-984

No.

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In the Supreme Court of the United States

OCTOBER TERM, 1987

SHELL OIL COMPANY, APPELLANT

v.

THE IOWA DEPARTMENT OF REVENUE, APPELLEE

On Appeal from the Supreme Court of Iowa

JURISDICTIONAL STATEMENT

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QUESTION PRESENTED

Whether the Outer Continental Shelf Lands Act, 43 U.S.C. §§ 1331 *et seq.*, prohibits the states from taxing income earned from the extraction of oil and gas from the outer Continental Shelf.

PARTIES TO THE PROCEEDING AND RULE 28.1 STATEMENT

All of the parties to the appeal of Shell Oil Company in the Supreme Court of Iowa are listed in the caption to this Jurisdictional Statement. Kelly-Springfield Tire Co. was a party to a separate appeal that was consolidated with the Shell appeal in the Iowa Supreme Court because of an issue, entirely unrelated to the question presented in this Court, that was common to the two appeals below.

Shell Oil Company's parent companies, subsidiaries (excluding wholly-owned subsidiaries) and affiliates are listed in Appendix G, *infra*, 97a-103a.

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In the Supreme Court of the United States

OCTOBER TERM, 1987

No.

SHELL OIL COMPANY, APPELLANT

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THE IOWA DEPARTMENT OF REVENUE, APPELLEE

On Appeal from the Supreme Court of Iowa

JURISDICTIONAL STATEMENT

OPINIONS BELOW

The opinion of the Supreme Court of Iowa (App., *infra*, 1a-14a) is reported at 414 N.W.2d 113. The opinion of the District Court of Polk County (App., *infra*, 15a-35a) is not reported.

JURISDICTION

The judgment of the Supreme Court of Iowa was entered on October 21, 1987 (App., *infra*, 1a). A notice of appeal to this Court (App., *infra*, 92a-93a) was filed on November 23, 1987. The jurisdiction of the Court over this appeal is invoked under 28 U.S.C. § 1257(2).

CONSTITUTIONAL AND STATUTORY PROVISIONS INVOLVED

This case presents the question whether the Iowa corporate income tax code, as applied to appellant Shell Oil Company, is invalid under the Supremacy Clause of the

United States Constitution (Art. VI, cl. 2) to the extent that it conflicts with the provisions of the Outer Continental Shelf Lands Act ("OCSLA"), 43 U.S.C. §§ 1331 *et seq.* The relevant provisions of the OCSLA and the Iowa corporate income tax code are set forth in App., *infra*, 94a-96a.

STATEMENT

This case is a companion to *Shell Oil Co.* v. *Department of Revenue, State of Florida*, appeal pending, No. 86-1593 (filed Mar. 20, 1987). It presents the question whether the Outer Continental Shelf Lands Act ("OCSLA"), 43 U.S.C. §§ 1331 *et seq.*, prohibits states from taxing income earned from the extraction of oil and gas on the outer Continental Shelf ("OCS") pursuant to federal lease.[1] Contrary to the decision below, such taxation is invalid under the OCSLA and the Supremacy Clause because it is inconsistent with the exclusive jurisdiction of the federal government over the OCS, with the explicit language of the OCSLA that state taxation laws "shall not apply" to the OCS, and with the congressional policy of prohibiting state taxes of OCS production in order to enhance the federal government's revenues from lease payments and to promote development of the OCS.

A. The Outer Continental Shelf Lands Act

The outer Continental Shelf is defined as all submerged lands appertaining to the United States that are outside the area three geographical miles (three marine leagues in the case of Florida and Texas) from the coastline of the United States. See 43 U.S.C. §§ 1331(a) and 1301 (a)(2). The OCS lies off the shores of the continental

[1] The term "income earned" refers to the portion of income from the sale of OCS oil and gas that is attributable to the extraction of the resource on the OCS. In other words, it is the increment of income that represents the net value at the wellhead (*i.e.*, fair market value less related costs and expenses) of the OCS production.

United States, Alaska, and Hawaii, and is not located within any of the 50 states. App., *infra*, 18a-19a.

Beginning in the 1930s, a dispute developed between the federal government and the states over off-shore lands (both inside and outside the three-mile limit) and the natural resources they contain. In a series of decisions, this Court held that the states were "not the owner of the three-mile marginal belt along [the] coast, and that the Federal Government rather than [a] state has paramount rights in and power over that belt, an incident to which is full dominion over the resources of the soil under that water area, including oil." *United States* v. *California*, 332 U.S. 19, 38-39 (1947); see also *United States* v. *Louisiana*, 339 U.S. 699, 705 (1950) ("[i]f, as we held in California's Case, the three-mile belt is in the domain of the Nation rather than of separate States, if follows *a fortiori* that the ocean beyond that limit also is"); *United States* v. *Texas*, 339 U.S. 707 (1950).

In response to these rulings recognizing the paramount rights of the United States in such off-shore areas, Congress in 1953 enacted two statutes. First, in the Submerged Lands Act, 43 U.S.C. §§ 1301-1315, Congress relinquished to the states title to and ownership of the submerged lands and natural resources within the three-mile limit. By that Act "the United States, in effect, quitclaimed to [the states] whatever interest the Federal Government may have had in, and to, all lands and natural resources lying within three geographical miles seaward of the * * * coastline." *United States* v. *California*, 447 U.S. 1, 3 (1980); see also *Secretary of Interior* v. *California*, 464 U.S. 312, 315-316 (1984); *United States* v. *Louisiana*, 363 U.S. 1, 6-7 (1960).

Second, Congress adopted the Outer Continental Shelf Lands Act, 43 U.S.C. §§ 1331-1356. The OSCLA declares that the outer Continental Shelf is "subject to [the]

jurisdiction [and] control [of the United States]" (43 U.S.C. § 1332(1)) and is "an area of exclusive Federal jurisdiction" (43 U.S.C. § 1333(a)(1)). Accordingly, the "Constitution and laws" of the United States were extended to the OCS (*ibid.*). Moreover, "to fill the substantial 'gaps' in the coverage of federal law, OSCLA borrows the 'applicable and not inconsistent' laws of the adjacent States as surrogate federal law." *Gulf Offshore Co.* v. *Mobil Oil Corp.*, 453 U.S. 473, 480 (1981); see 43 U.S.C. § 1333(a)(2)(A); *Rodrigue* v. *Aetna Casualty & Surety Co.*, 395 U.S. 352, 356-359 (1969). This Court has recognized that the OCSLA establishes "the exclusive jurisdiction and control of the Federal Government" over the OCS (*Gulf Offshore*, 453 U.S. at 479 n.7).

In addition to providing that the OCS is an area of exclusive federal jurisdiction, the OCSLA specifically addresses the issue of state taxation. Section 1333(a)(2)(A) provides that "State taxation laws shall not apply to the outer Continental Shelf." This prohibition is reinforced by Section 1333(a)(3), which directs that the OCSLA "shall never be interpreted as a basis" for a state to claim "any interest in or jurisdiction * * * over the seabed and subsoil of the outer Continental Shelf, or the property and natural resources thereof or the revenues therefrom."

The OCSLA recognizes that "the outer Continental Shelf is a vital national resource reserve" that "should be made available for expeditious and orderly development" (43 U.S.C. § 1332(3)). In furtherance of that policy, the federal government has established a system of competitive bidding to lease OCS lands for the exploration, development, and production of crude oil, natural gas, and other minerals. See 43 U.S.C. §§ 1334, 1337. Although the Act authorizes several alternatives, a lessee generally pays the government a cash bonus when its bid is accepted, a fixed delay rental during the period prior to production, and a production royalty that

is normally one-sixth of the value of production as measured by the volume of production times the industry posted price at the wellhead. *Watt* v. *Energy Action Educational Foundation*, 454 U.S. 151, 153-154 (1981). Between 1954 and 1985, the federal government received some $52.7 billion in OCS lease bonus payments, $28.1 billion in royalties, and $0.7 billion in other revenues. U.S. Dep't of the Interior, *Federal Offshore Statistics: 1985*, Tables 2 & 16.

B. Shell's OCS Oil And Gas Activities

Appellant Shell Oil Company is a Delaware corporation with business operations in all 50 states and the District of Columbia. Shell is engaged in the exploration for, and the development, production, transportation, purchasing, and marketing of, crude oil and natural gas, and in the purchase, manufacture, and marketing of oil and chemical products. App., *infra*, 16a.[2]

Pursuant to leases obtained from the federal government through competitive bidding, Shell explores for and extracts crude oil and natural gas on the OCS. App., *infra*, 19a; Stip. ¶ 23. During the past decade, Shell has paid the government more than $2.2 billion in cash bonuses on Gulf of Mexico and Atlantic federal off-shore leases, $18 million in pre-production rentals, and $2.4 billion in royalties.

Shell controls the disposition of the crude oil and natural gas that it extracts from the OCS. Shell sells all of its gas production to third parties on the Shelf. See *Maryland* v. *Louisiana*, 451 U.S. 725, 730, 731 (1981) (most OCS gas is sold at the wellhead). In contrast, while Shell sells a small portion of its OCS oil on the

[2] The factual record in this case was stipulated by the parties, and the facts recited in the lower courts' opinions are based on that stipulation ("Stip."). The facts summarized in this Jurisdictional Statement relate to calendar years 1975-1980, the tax years in dispute below.

Shelf, most of its oil production is transferred internally between divisions of Shell on the OCS and is then brought to the mainland, where it is either sold to third parties or refined by Shell for subsequent sale. App., *infra*, 17a, 20a; Stip., ¶ 23.

The oil and gas extracted from the OCS has a determinable fair market value at the wellhead. The market value of the gas is the actual price at which it is sold to third parties on the Shelf, which is determined by contract in compliance with federal regulations. With respect to OCS oil, Shell determines fair market value based on the industry posted price on the OCS (*i.e.*, prior to transportation and processing); Shell uses that market value not only in its corporate accounting system maintained in the ordinary course of business, but also in computing royalty payments to the government pursuant to OCS leases, in establishing depletion allowances under the Internal Revenue Code, and in calculating the federal excise tax on windfall profits. The fair market value of OCS production, less related costs and expenses, represents the income earned from the extraction of oil and gas on the OCS. App., *infra*, 17a; Stip., ¶ 23. See note 1, *supra*.

C. Iowa's Apportioned Tax System

Shell's principal business in Iowa consists of marketing oil and chemical products that it has refined and manufactured. It is not possible to determine whether the products sold in Iowa were derived from OCS or non-OCS oil. App., *infra*, 17a-20a. Shell's operations constitute a "unitary business" substantially similar to that in *Exxon Corp.* v. *Wisconsin Dept. of Revenue*, 447 U.S. 207 (1980). App., *infra*, 18a. Because Shell is a unitary business, its corporate income tax in Iowa is determined under the State's apportionment methodology.

Formula apportionment is a recognized method for determining the portion of the aggregate income of a

multistate unitary business that is attributable to a given state and thus taxable by that state. "[N]et income from all sources [not allocated to a specific situs], whether within or without the State, includable in the tax base * * * becomes the apportionable base to which the formula is applied." J. Hellerstein, *State Taxation* ¶ 9.1 at 478 (1983). See, *e.g.*, *ASARCO, Inc.* v. *Idaho State Tax Comm'n*, 458 U.S. 307, 333-334 (1982); *Mobil Oil Corp.* v. *Vermont Comm'r of Taxes*, 445 U.S. 425, 437-439 (1980).

Section 422.33 of the Iowa Tax Code applies a one-factor apportionment formula based on sales inside and outside the State. See *Moorman Manufacturing Co.* v. *Bair*, 437 U.S. 267 (1978). As described by the Iowa District Court (App., *infra*, 26a-27a):

> The formula for calculating that portion of a multistate corporation's income subject to Iowa income tax under the one factor formula is as follows:

$$\left(\frac{\text{Iowa Gross Sales}}{\text{Everywhere Gross Sales}}\right) \times \left(\begin{matrix}\text{Federal Taxable Income} \\ \text{Adjusted Per Iowa Law}\end{matrix}\right) = \text{Iowa Income}$$

At issue in this case is the proper determination of the income base (*i.e.*, the adjusted "Federal Taxable Income" component above) to which the apportionment factor is to be applied to calculate Iowa income.[3] Shell submits that the OCSLA prohibits states from taxing the income earned from oil and gas that it extracted from the OCS and therefore that the net wellhead value of that produc-

[3] In contrast to Iowa, most other apportionment jurisdictions (including Florida) utilize some form of three-factor formula based on payroll, property, and sales. The difference between the one-factor and three-factor methodologies does not affect the question presented in this appeal: what is to be included in the income base that is subject to apportionment.

tion must be excluded from the income base that is apportionable among the states.[4]

D. The Proceedings Below

This appeal involves Shell's Iowa taxes for the years 1978-1980.[5] The Iowa Department of Revenue issued a Notice of Assessment to Shell based on the inclusion of Shell's OCS income in the apportionable tax base.[6]

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[4] In equation form, Shell contends that the apportionable income base is:

$$\left(\begin{array}{c}\text{Federal Taxable Income}\\ \text{Adjusted Per Iowa Law}\end{array}\right) - \left(\begin{array}{c}\text{Income Earned From}\\ \text{OCS Production}\end{array}\right) = \begin{array}{c}\text{Non-OCS}\\ \text{Taxable Income}\end{array}$$

Because, for consistency, the apportionment factor also would have to be adjusted for OCS sales, Shell's income taxable in Iowa would be (App., *infra*, 27a):

$$\left(\frac{\text{Iowa Gross Sales}}{\begin{array}{c}\text{Everywhere Gross Sales}\\ -\text{OCS Gross Sales}\end{array}}\right) \times \left(\begin{array}{c}\text{Non-OCS}\\ \text{Taxable Income}\end{array}\right) = \text{Iowa Income}$$

[5] In the courts below, Shell's OCS argument also encompassed the tax years 1975-1977, but the Iowa Supreme Court's decision on unrelated state-law grounds (App., *infra*, 2a-7a) has now resolved those earlier years in Shell's favor.

[6] The amounts in dispute due to the OCS issue were as follows:

	Income Apportioned To Iowa		Differences In Tax On Account Of OCS Issue	
Year	Department Method ($)	Shell Method ($)	Increase (Decrease) In Tax Per Assessment ($)	Increase (Decrease) In Tax Per Assessment (%)
1975	3,457,254	3,043,554	41,369	13.7%
1976	4,773,053	3,847,942	62,511	16.3%
1977	3,741,663	3,506,061	23,460	6.7%
1978	3,698,792	3,784,909	(8,612)	(2.3)%
1979	5,584,753	4,898,861	71,590	14.8%
1980	4,671,395	3,813,008	85,839	22.7%

See Shell's Opening Brief (at 5) and Reply Brief (at 14) in the Iowa Supreme Court (figures derived from Exh. 7, Iowa S.Ct. App. 182-187). As tax year 1978 illustrates, the exclusion of OCS income can result in *higher* taxes if OCS operations represent a loss rather than a gain.

After the Department of Revenue rejected Shell's administrative protest (App., *infra*, 36a-38a, 39a-91a), Shell sought judicial review in the Iowa District Court for Polk County. That court sustained the Department's inclusion of OCS income in the apportionable base, holding that the OCSLA does not prevent states "from indirectly taxing some portion of OCS activities pursuant to a constitutionally permissible apportionment scheme related to [the taxpayer's] sales in the taxing state" (*id.* at 31a).

The Iowa Supreme Court affirmed this ruling. App., *infra*, 7a-14a. Based on the legislative history of the OCSLA, the court below construed "the language restricting the application of state taxation laws to the OCS and denying to the state any interest in the natural resources or revenues from the seabed and subsoil of the OCS [to be] intended as a limitation on the authority of states adjacent to OCS lands to extend legislative jurisdiction to the OCS" (*id.* at 10a). Given this construction, the court held that the OCSLA does not bar Iowa's taxation of Shell's OCS income (*id.* at 11a):

> [Iowa's tax] is in no way dependent upon the exercise of legislative jurisdiction on OCS lands. Its taxing jurisdiction depends instead on the nexus of Shell's activities within this state. The inclusion of some OCS revenues in the apportionment formula is simply a method of obtaining an acceptable measure of the local nexus.

The Iowa Supreme Court made clear that the State could include in the tax base Shell's earnings from *all* OCS oil and gas, whether Shell's sales of those OCS products occurred on or off the Shelf. Discussing the related decision in *Shell Oil Co.* v. *Department of Revenue*, 496 So.2d 789 (Fla. 1986), appeal pending, No. 86-1593 (U.S. filed Mar. 20, 1987), which upheld the inclusion of

OCS income in the apportionment base, the court noted that the Florida case "had excluded from the[] apportionment formula that portion of Shell's gross revenues which were derived from sales made on OCS lands" (App., *infra*, 10a). In contrast, "[i]n the present case, Iowa has apparently included in its gross apportionment formula some revenues derived by Shell from the sale of natural gas at the platform on the OCS" (*ibid.*). Without further explanation, the court concluded that "[w]e do not believe, however, that this distinction warrants a result in the present case which differs from the one reached by the Florida court" (*ibid.*). Thus, under the decision below, every state is free to tax its apportioned share of all of Shell's ICS income, including income from sales to third parties that take place on the outer Continental Shelf itself.

THE QUESTION IS SUBSTANTIAL

This appeal presents the interrelated issues whether the OCSLA permits states to tax the income earned from oil and gas that the taxpayer extracts from the OCS pursuant to federal lease and (1) sells to third parties on the Shelf or (2) transports to the mainland for subsequent sale to third parties. The second issue is identical to that presented in Shell's pending appeal to this Court in *Shell Oil Co.* v. *Department of Revenue, State of Florida*, No. 86-1593 (filed Mar. 20, 1987). In the Florida case, the Solicitor General has filed an *amicus curiae* brief recommending that the Court grant review of the issue concerning OCS income from off-Shelf sales. Review of that issue is equally warranted here.

As to the issue regarding income from on-Shelf sales, the need for this Court's review is even more clearly indicated. The difference between the decisions of the Iowa and Florida Supreme Courts will be a source of confusion for state tax administrators and multistate corporations alike over the limits imposed by the OCSLA on state taxation of oil and gas sales that occur on the OCS.

Moreover, the Solicitor General's *amicus curiae* brief recognized that the OCSLA prohibits states from taxing OCS income from sales on the Shelf (U.S. Am. Br. 6, 16):

> [A]s Florida has properly conceded * * *[,] a State [may not], consistently with the Supremacy Clause, tax income earned by Shell from OCS oil or gas sales that are completed on the OCS itself.
>
> * * * * * *
>
> Florida has conceded, as it must, that Shell's sales of OCS oil to independent third parties, if completed on the OCS itself, are immune from state income taxation.

Indeed, with specific reference to the instant case then pending in the Iowa Supreme Court, the Solicitor General stated that a decision sustaining apportionment of OCS income from sales on the Shelf would be in "error," would be contrary to the interests of the federal government, and would be appropriate for this Court's review (*id.* at 16, 17 & n.12).

The question presented in this appeal, which is within the Court's mandatory jurisdiction, is of considerable public importance. More than 40 states and the District of Columbia use formula apportionment to tax the income of multistate unitary businesses. Both multistate taxpayers and the taxing authorities in these jurisdictions—only one of which (Kentucky) has excluded the total income derived from OCS oil and gas—will be directly affected by the Court's resolution of this case. As the Solicitor General has noted, tax issues concerning OCS oil and gas are of substantial significance "to oil companies and to the States, given the magnitude of the off-shore leasing program" (U.S. Am. Br. 17). Plenary review of Shell's appeal is plainly warranted.[7]

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[7] This case relates only to taxation of the income earned from the extraction of oil and gas on the OCS. See note 1, *supra*. States are free, of course, to tax the portion of a taxpayer's income that is attributable to the subsequent transporting, processing, and marketing of OCS production.

A. The OCSLA Prohibits States From Taxing The Income Earned From The Extraction Of Oil And Gas On The OCS

Unlike most state income tax cases that the Court has decided, this appeal does not involve a challenge to the validity of the apportionment formula used to prorate among the states the aggregate income of a multistate unitary business. Instead, this case presents the antecedent question of what may be included in the income base that is subject to apportionment. See *Mobil Oil Corp.* v. *Vermont Comm'r of Taxes*, 445 U.S. 425, 434-435 (1980).[8] Here, that question is answered by the OCSLA, which requires states to exclude OCS oil and gas income from apportioned taxation. Just as Congress has determined that other significant federal interests warrant granting an immunity from state income tax laws (see, *e.g.*, 31 U.S.C. § 3124(a) (states may not tax dividend and interest income derived from federal securities); 23 Iowa Code § 422.35(1)), so, too, Congress has concluded that state taxation of income derived from production on the outer Continental Shelf would frustrate its policies in that exclusively federal domain.

1. *The plain language of the OCSLA prohibits Iowa's tax on Shell's OCS oil and gas income*

Iowa's income tax indisputably imposes a levy on the income Shell earned from the extraction of oil and gas from the OCS pursuant to federal lease. That income, by virtue of its inclusion in Shell's apportionable income from sales of OCS oil and gas, is reflected in Iowa's pro rata share of income that is the basis for computing Shell's tax liability to the State. Iowa's taxation of Shell's OCS oil and gas income is prohibited by the plain language of the OCSLA.

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[8] Because Shell's contention is that states cannot tax OCS oil and gas income at all, the same question would be presented if Iowa were the only state in which Shell did business.

By its express terms, the OCSLA asserts the "jurisdiction" and "control" of the United States over the OCS (43 U.S.C. § 1332(1)) as a "vital national resource reserve" that "should be made available for expeditious * * * development" (43 U.S.C. § 1332(3)). Accordingly, in extending the Constitution and laws of the United States to the Shelf, the Act provides that the OCS is "an area of exclusive Federal jurisdiction" (43 U.S.C. § 1333 (a)(1)).

Under settled principles, states cannot impose a tax on private property or persons within an area of exclusive federal jurisdiction, absent the consent of Congress. Exclusive federal jurisdiction "is in essence complete sovereignty. That is, not only is the federal property immune from taxation because of the supremacy of the Federal Government, but state laws, not adopted directly or impliedly by the United States, are ineffective to tax or regulate other property or persons upon that enclave." *S.R.A.* v. *Minnesota*, 327 U.S. 558, 562-563 (1946). Thus, "[w]herever the United States has such jurisdiction the State would have no authority to lay the tax." *James* v. *Dravo Contracting Co.*, 302 U.S. 134, 140 (1937). In *Humble Pipe Line Co.* v. *Waggonner*, 376 U.S. 369 (1964), for example, the Court applied these principles to hold that the state could not tax a private party who had leased land in an exclusive federal enclave to develop oil and gas reserves. Similarly, in *Ramah Navajo School Bd.* v. *New Mexico Bureau of Revenue*, 458 U.S. 832 (1982), the Court held that the state could not impose a gross receipts tax on a non-Indian construction company engaged in building a school on an Indian reservation.

Given the explicit provision in Section 1333(a)(1) that the outer Continental Shelf is an area of exclusive federal jurisdiction, this analysis normally would be sufficient to prevent state taxation based on OCS activities. However, because 43 U.S.C. § 1333(a)(2)(A) incorpo-

rates certain state laws as surrogate federal law applicable to the OCS (see page 4, *supra*), Congress could not rest with the general preemptive implications of exclusive federal jurisdiction. Instead, it affirmatively exercised its plenary authority over federal property (see, *e.g.*, *Kleppe* v. *New Mexico*, 426 U.S. 529, 540-546 (1976)) to enact two additional provisions that confirm the invalidity of state taxation of income earned from the extraction of OCS oil and gas.

First, in language that is noteworthy for its clarity and directness, Congress declared: "State taxation laws shall not apply to the outer Continental Shelf" (43 U.S.C. § 1333(a)(2)(A)). It is hard to imagine simpler or more sweeping language to prohibit state taxation of the income attributable to the production of oil and gas on the Shelf.

Second, Congress provided that the OCSLA "shall never be interpreted" as a basis for a state to claim "any interest in or jurisdiction * * * over * * * the revenues" from the OCS (43 U.S.C. § 1333(a)(3)). This emphatic prohibition precludes Iowa from claiming "any interest" in Shell's apportioned "revenues" from OCS oil and gas.

Other provisions of the OCSLA confirm the view that state taxation of OCS activities is impermissible. For example, the Mineral Leasing Act, 30 U.S.C. § 189, expressly allows states "to levy and collect taxes upon * * * any lessee of the United States." See *Commonwealth Edison Co.* v. *Montana*, 453 U.S. 609, 631-632 (1981). However, Congress chose to make the Mineral Leasing Act inapplicable to the OCS by providing that "mineral leases on the outer Continental Shelf shall be maintained or issued only under the provisions of [the OCSLA]" [43 U.S.C. § 1333(a)(1)).

Significantly, Congress also did not extend the Buck Act to the OCS. The Buck Act of 1940, 4 U.S.C. §§ 105-

110, constitutes congressional authorization for states to impose specified taxes on people or property in federal areas. See *United States* v. *Mississippi Tax Comm'n*, 421 U.S. 599, 603, 611 (1975). In particular, 4 U.S.C. § 106 provides that a state shall have "full jurisdiction and power to levy and collect" income taxes in any federal area within the state, and that "[n]o person shall be relieved from liability for any income tax levied by any State * * * by reason of his * * * receiving income from transactions occurring or services performed" in a federal area. However, because the Buck Act is restricted to federal areas "located within the exterior boundaries" of a state (4 U.S.C. § 110(e)), it is inapplicable to the OCS. The failure of the OCSLA to incorporate the Buck Act's specific authorization for state income taxes is telling evidence that reinforces the conclusion that states may not tax the income Shell earned from the extraction of OCS oil and gas.

2. The legislative history and policies of the OCSLA preclude Iowa's tax on Shell's OCS oil and gas income

Where, as here, the express provisions of a federal statute prohibit a state tax, it is unnecessary for courts to look behind the statute to consider the legislative history and congressional policies underlying the prohibition. See, *e.g.*, *Aloha Airlines* v. *Hawaii Director of Taxation*, 464 U.S. 7, 12 (1983). In any event, the history and purposes of the OCSLA further demonstrate that Iowa's tax on Shell's OCS oil and gas income is invalid.

The legislative history of the OCSLA is extensive, involving a number of separate bills introduced and debated over several Congresses. But for present purposes, one feature of this history stands out: the states made repeated attempts to obtain tax or lease revenues from the OCS, which Congress consistently rejected in order to preserve exclusive federal jurisdiction over, and exclusive federal revenues from, the OCS.

Numerous proposals were introduced in Congress to enable states to share directly or indirectly in the wealth of the OCS. These included proposals: to extend state police powers, including the taxing power, to the OCS;[9] to permit the states to impose severance or production taxes but to exclude all other forms of taxation;[10] to apply the Mineral Leasing Act to the OCS, which would have allowed the states to levy taxes (see page 14, *supra*);[11] to provide states with a portion of the royalties paid to the United States for OCS leases;[12] to establish a joint congressional committee to determine federal reimbursement to the states for services provided to OCS lessees and their employees;[13] and to use the proceeds of OCS leases for grants to public education, which would have redounded largely to the financial benefit of the states.[14] In the end, however, all of these proposals were defeated, and both the House bill (whose language was incorporated in 43 U.S.C. § 1333(a)(2)(A)) and the Senate bill (whose language was incorporated in 43 U.S.C. § 1333(a)(3)) were in agreement that the states were not entitled to any part of the tax or lease revenues from the OCS.[15]

The power of the states to tax OCS activities was repeatedly discussed and emphatically denied by Congress. For example, the Senate Report on the OCSLA explained

[9] See H.R. Rep. No. 695, 82d Cong., 1st Sess. 7, 13 (1951); *Outer Continental Shelf: Hearings on S. 1901 Before the Senate Comm. on Interior and Insular Affairs*, 83d Cong., 1st Sess. 471 (1953).

[10] See H.R. Rep. No. 215, 83d Cong., 1st Sess. 7-8 (1953).

[11] See S. Rep. No. 411, 83d Cong., 1st Sess. 23, 37 (1953); 99 Cong. Rec. 6966 (1953) (remarks of Sen. Cordon).

[12] See S. Rep. No. 411, at 3.

[13] See 99 Cong. Rec. 7251-7255 (1953).

[14] See S. Rep. No. 411, at 3.

[15] See H.R. Conf. Rep. No. 1031, 83d Cong., 1st Sess. 12 (1953).

that state taxation laws "necessarily are excluded" from the OCS, a proposition that Section 1333(a)(3) made "plain" in "precise unequivocal language."[16] Similarly, Representative Keating, in introducing the amendment to the House bill that eventually was enacted as the state tax prohibition in Section 1333(a)(2)(A), referred to the position of the Secretary of the Interior that states "should have no taxing power whatsoever on the outer Continental Shelf" and "should be given nothing from the resources."[17] In the words of the Conference Report, "State taxation laws are specifically banned."[18]

Congress well understood the absolute and sweeping nature of the prohibition on state taxes. For example, Representative Boggs, in a colloquy with Representative Keating, explained that the Keating amendment "strikes out any participation by the States in the taxing of these resources."[19] Likewise, Representative Brooks observed that OCS lessees would be "immune to State and local laws as far as taxes are concerned."[20] And Representative Graham noted that "taxing powers" were "completely denied to the States."[21] The Senate debates equally reflected that "the sole jurisdiction, control, and right to tax *in any form* is in the United States"[22] and that states would not be permitted to "tax[] private lessees engaged in operations on the outer shelf."[23]

Senator Long of Louisiana, whose State was intensely interested in the taxing and revenue provisions in the

[16] See S. Rep. No. 411, at 3, 23, 11.

[17] 99 Cong. Rec. 2572 (1953).

[18] H.R. Conf. Rep. No. 1031, at 12.

[19] 99 Cong. Rec. 2572 (1953).

[20] *Id.* at 2577.

[21] *Id.* at 4883.

[22] *Id.* at 7234 (remarks of Sen. Cordon) (emphasis added).

[23] *Id.* at 7259 (remarks of Sen. Daniel).

OCSLA, correctly perceived the restrictions on state taxing power that are relevant in this case. In particular, noting in the Senate Report that the Act "den[ied] the States any power of taxation," [24] Senator Long recognized that OCS lessees would be "subject neither to the State's severance tax, property tax, *nor the tax on corporate profits.*" [25] He later reiterated these points on the floor, adding that OCS lessees "are beyond the reach of the State." [26] At no time in the legislative debates on the OCSLA did anyone express disagreement with Senator Long or correct his understanding of the Act.

Congress's determination to prohibit state taxation of OCS oil and gas reflected two basic considerations. First, the OCS was regarded as "peculiarly a matter" of federal concern [27] and "uniquely an area of exclusive Federal jurisdiction and control." [28] OCS lands "are wholly outside the boundary of any State" [29] and—as this Court recognized in its decisions in the *California*, *Louisiana*, and *Texas* cases—the "States never had title to this territory." [30] Thus, "'[t]he situation is not comparable to that of federally owned areas within a State * * *.'" [31] Rather, the OCSLA was considered to be "unique legislation" that recognized "that the assets obtained from * * * [the OCS] shall be regarded as purely and wholly Federal assets, and that the profits obtained therefrom shall be

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[24] S. Rep. No. 411, at 65 (minority report).

[25] *Id.* at 67 (emphasis added).

[26] 99 Cong. Rec. 7260-7261 (1953).

[27] S. Rep. No. 411, at 6.

[28] 99 Cong. Rec. 6963 (1953) (remarks of Sen. Cordon).

[29] *Id.* at 10472 (remarks of Sen. Cordon).

[30] *Id.* at 2499 (remarks of Rep. Celler).

[31] S. Rep. No. 411, at 6. See also 99 Cong. Rec. 7254 (1953) (remarks of Sen. Cordon).

regarded as profits belonging to the Federal Government and as revenue of the Federal Government." [32]

Second, Congress was concerned that state taxation would both diminish federal revenues from OCS leases and impair the national interest in the prompt development of OCS resources. Representative Keating explained this concern in connection with his amendment to prohibit state taxes, pointing out that such levies on OCS oil and gas would decrease the net value of the leases and thus reduce the amounts lessees would be willing to pay to the government:

> My concern is for the taxpayers of the United States, for in truth it would be their money we would be generous with if we leave the present wording in the bill.
>
> The tax imposed by the adjacent States would fall, at least indirectly, on the United States, the landlord of this area, since the terms of any lease entered into would have to be fixed in order to permit the lessees a fair return and a proper incentive to develop the area.[33]

As this Court recognized in *Maryland* v. *Louisiana*, 451 U.S. 725, 752-753 n.26 (1981), "[t]he proper fee or charge for drilling * * * on the OCS is a determination which is *solely* within the province of the Federal Government," and "[p]ermitting the States to exercise such power [of taxation] would *adversely affect the price which the Government could command from private developers in their bid price*" (second emphasis added).[34]

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[32] 99 Cong. Rec. 7252 (1953) (remarks of Sen. Holland).

[33] *Id.* at 2571. Other members of Congress noted that state taxes would "bring about an increased cost in the price of oil and gas" to consumers throughout the country (*id.* at 2527 (remarks of Rep. Madden)), including the United States in its purchases of oil for the national defense (*id.* at 2535 (remarks of Rep. Yates)).

[34] The importance of the government's financial interest in OCS leases was reinforced in the 1978 amendments to the OCSLA. As

In the same way, state taxation of OCS oil and gas income would, as Representative Keating noted in the foregoing remarks, impede a "fair return" to lessees and interfere with the "proper incentive" for them to develop the OCS. In 43 U.S.C. § 1332(3), Congress declared as a matter of federal policy that the OCS "is a vital national resource reserve" that "should be made available for expeditious * * * development." See also, *e.g.*, H.R. Rep. No. 413, 83d Cong., 2d Sess. 2 (1953) (the "principal purpose" of the OCSLA was to authorize the leasing and development of the OCS, and the "importance and necessity" for the legislation reflected the congressional policy that "the development and operation of [the OCS] are vital to our national economy and security"). State taxes would burden this national policy; as Congress itself recognized with respect to royalties, payments should not be "made so high that companies will not feel like operating the lands." [35]

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this Court explained in *Watt* v. *Energy Action Educational Foundation*, 454 U.S. 151 (1981), "[i]n passing the 1978 Amendments, Congress committed the Government to the goal of obtaining fair market value for OCS oil and gas reserves" (*id.* at 162, citing 43 U.S.C. § 1344(a)(4)) and sought to " 'secure higher returns to the public Treasury' " (454 U.S. at 167 n.18, quoting H.R. Rep. No. 95-590, 95th Cong., 1st Sess. 47 (1977)). Indeed, by authorizing the Secretary of the Interior to experiment with systems of lease payments based on lessees' net OCS profits (454 U.S. at 155 & nn. 3, 5), the 1978 amendments gave the government a direct interest in the profitability of OCS production (see 454 U.S. at 166-167 n.18)—an interest that would be adversely affected by state taxation of OCS oil and gas income.

[35] 99 Cong. Rec. 6965 (1953) (remarks of Sen. Martin).

The policy of providing an incentive to companies to develop the OCS was reiterated in the 1978 amendments to the OCSLA. The amendments emphasized the continuing need for " 'discovering and recovering oil and gas' " and " 'developing new oil and gas resources in an efficient and timely manner.' " *Watt* v. *Energy Action Educational Foundation*, 454 U.S. at 164 n.16, quoting H.R. Conf. Rep. No. 95-1474, 95th Cong., 2d Sess. 92 (1978). See also *Secretary of Interior* v. *California*, 464 U.S. 312, 336 (1984). To that end, the

3. *The OCSLA prohibition of state taxation applies to all OCS income, whether the oil and gas is sold on or off the Shelf*

The text, history, and policies of the OCSLA demonstrate that state taxation of the income earned from the extraction of OCS oil and gas is inconsistent with federal law. However, the Solicitor General, in line with the concession of the State of Florida, has attempted to draw a distinction based on the place of sale of OCS production to a third party. In the government's view, an apportioned corporate income tax like that imposed by Iowa and Florida cannot include profits earned by the taxpayer-lessee from the sales of OCS oil or gas to a third party on the Shelf itself, but may include such profits if the taxpayer transports the oil or gas to the mainland and then sells it to a third party in the United States. We agree with the former but not the latter conclusion; nothing in the OCSLA carves out an exception to the state tax prohibition for OCS oil and gas that is sold off the Shelf.

a. *OCS production sold on the Shelf*

With respect to OCS oil and gas that is sold on the Shelf, the applicability of the OCSLA state tax prohibition is manifest. The income being taxed consists of nothing but the net value of the resources extracted from the OCS. That production has no geographical nexus to any area but the OCS at the time it is conveyed by the taxpayer-lessee.[36] And all of the events giving rise to the

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amendments were intended to " 'provid[e] the incentive of a fair profit to the oil companies, which must risk their investment capital' " (454 U.S. at 164 n.16, quoting H.R. Rep. No. 95-590, at 54), and to " 'increase the availability of funds for exploration' " (454 U.S. at 166 n.18, quoting S. Rep. No. 95-284, 95th Cong., 1st Sess. 46-47 (1977)).

[36] See *Exxon Corp.* v. *Wisconsin Dept. of Revenue*, 447 U.S. 207, 225-226 & n.10 (1980) (income from the sale of non-OCS oil and gas to third parties at the wellhead was allocated by statute to the situs state and excluded from apportionment).

lessee's tax liability for the income earned—the extraction of the oil and gas and the realization of gain through its sale—have occurred within this exclusive federal enclave. In the most literal sense, state taxes have, in contravention of the OCSLA, been "appl[ied] to the outer Continental Shelf" (43 U.S.C. § 1333(a)(2)(A)), and the state has "claim[ed]" an "interest" in the apportioned "revenues" from the OCS activities (43 U.S.C. § 1333 (a)(3)).

Moreover, the dual policies underlying the OCSLA—to promote development of the OCS through incentives to lessees, and to enhance the government's revenues from lease payments—are directly implicated in this situation. To tax the income of an OCS lessee who extracted and sold minerals entirely on the Shelf would impose a direct burden on the profitability of the OCS operation, thereby reducing the lessee's incentive to undertake development and lowering the value of the rights for which lease payments will be made to the government.[37]

Accordingly, as the Solicitor General acknowledges, and as Florida concedes, the OCSLA requires that state taxes exclude from the apportionable income base the earnings attributable to oil and gas that the taxpayer-lessee extracts from the OCS and sells to a third party on the Shelf.

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[37] In analogous circumstances in *White Mountain Apache Tribe* v. *Bracker*, 448 U.S. 136 (1980), the Court held that a state could not impose a tax on non-Indian logging companies operating on a federal Indian reservation because such taxation would interfere with the federal "policy of assuring that the profits derived from timber sales will inure to the benefit of the Tribe" and "would undermine the Secretary's ability to make the wide range of determinations committed to his authority concerning the setting of fees and rates with respect to the harvesting and sale of tribal timber"; as a result, state taxes would impermissibly "reduc[e] tribal revenues and diminish[] the profitability of the enterprise for potential contractors." *Id.* at 149.

b. *OCS production sold off the Shelf*

That the ultimate sale of OCS oil or gas occurs off the Shelf cannot obscure the fact that the apportioned state tax includes the net value of the production at the very point at which the federal lessee extracts it from the OCS. While it may be easier to conceptualize the statutory violation in spatial terms when the sale as well as the production takes place on the Shelf, state taxation of off-Shelf sales equally falls on OCS oil and gas. Nothing in the language of the OCSLA or its purposes turns on the location of the ultimate sale of OCS production; whether the taxpayer-lessee elects to sell it immediately on the Shelf, to sell it once it is brought to the mainland, or to refine it or store it for later sale, state taxation of the OCS production income is subject to the same statutory prohibition and has the same adverse consequences for federal OCS policies.

The Solicitor General's *amicus curiae* brief offers several grounds for not applying the OCSLA state tax prohibition to OCS oil and gas sold outside the Shelf, but none of these justifies the government's position. First, the Solicitor General asserts (U.S. Am. Br. 16) that the OCSLA merely "codif[ies] the constitutional proscriptions, set forth in the Due Process and Commerce Clauses, against state efforts to tax values that lie outside their jurisdiction." However, that interpretation renders the statutory prohibition of state taxation superfluous and largely trivializes Congress's extensive and often contentious debate over the issue of state taxing authority. The Congress that enacted the OCSLA certainly thought it was doing something more than simply incorporating a well-established and indisputable constitutional principle.

The Solicitor General also argues (U.S. Am. Br. 15, 17) that the proper construction of the OCSLA should not turn on fiscal considerations regarding the lease revenues paid to the federal government or the economic incentives afforded lessees to develop the OCS. The legislative his-

tory of the OCSLA makes clear, however, that these interests were of central concern to Congress. See pages 18-20, *supra*. Indeed, the Solicitor General's brief itself concedes that Congress recognized that state taxation of OCS oil and gas "would necessarily decrease federal revenues" (U.S. Am. Br. 15 n.11). Contrary to the government's characterization, there is nothing "incidental[]" (*id.* at 15 & n.11) about state taxation of the income earned on oil and gas that a federal lessee extracts from the OCS. The prohibition of state taxes is an integral aspect of Congress's policies to enhance lease payments to the federal treasury and to encourage development of the OCS.

In addition, the Solicitor General notes (U.S. Am. Br. 11, 14) that Congress did not specifically focus on apportioned state income taxes in enacting the state tax prohibition. But that is no more true for off-Shelf sales than for on-Shelf sales, which also are not expressly mentioned in the legislative history but which the government nonetheless recognizes cannot be included in apportionable income. More to the point, the language, history, and policies of the OCSLA indicate that the Act was intended to prohibit state taxation, in *any* form, of OCS oil and gas income. At every turn, Congress rebuffed the states' efforts to reap tax revenues from the OCS. The statute bars "[s]tate taxation laws" without exception. Congress was not required to identify and rule out each individual tax that was meant to be proscribed. See, *e.g.*, *Aloha Airlines* v. *Hawaii Director of Taxation*, 464 U.S. at 12 n.6; *Harrison* v. *PPG Industries, Inc.*, 446 U.S. 578, 592 (1980).[38]

[38] The Solicitor General further relies (U.S. Am. Br. 9 n.7) on 43 U.S.C. § 1335(a)(9), which provides for an increase in OCS royalties by the amount of "severance, gross production, or occupation taxes" payable to the state under leases it issued prior to the enactment of the OCSLA. Because the OCSLA unquestionably prohibits these taxes, and because the purpose of Section 1335(a)(9) was to prevent a windfall to existing lessees who were being relieved of state taxes they had expected to pay, the Solicitor General suggests that the absence of apportioned state income taxes from this enumeration means that they are not covered by the OCSLA state tax prohibition.

Finally, the Solicitor General contends (U.S. Am. Br. 5, 6, 9-10, 16) that states may tax off-Shelf sales because, under general principles of income tax law, the income from such sales is "realized" within the states rather than on the OCS. But technical concepts of income realization have no relevance here. The state tax prohibition at issue in this case is governed by the language and policies of the OCSLA, not the provisions of the Internal Revenue Code. And that standard does not vary according to the location of the eventual sale. The Solicitor General offers no reason why the congressional prohibition of state taxes should depend on the place or time that income is realized from OCS production rather than on the incontrovertible fact that the value of that production is being taxed.[39]

Once again, however, the Solicitor General, having conceded that states cannot tax the value of OCS production sold on the Shelf, derives no support from Section 1335(a)(9) for his argument that they nevertheless can tax precisely the same value in the case of off-Shelf sales. Moreover, given the differences in computing taxes based on net income and taxes (like severance, gross production, and occupation taxes) based solely on the volume of production, it would have been completely infeasible to add to the federal royalty payment the amount of the state income tax that would have been due. Nor were apportioned state income taxes as common in 1953 as they are now; for example, the Uniform Division of Income for Tax Purposes Act (UDITPA) was not adopted until 1957. See *ASARCO, Inc.* v. *Idaho State Tax Comm'n*, 458 U.S. 307, 310 n.3 (1982). In addition, Section 1335(a)(9) applies only to leases issued by the state prior to the enactment of the OSCLA; for all subsequent leases, the federal royalty is *not* increased by the amount of the prohibited state tax, a result that Congress recognized would inure to the advantage of OCS developers over their competitors operating on the mainland and subject to state taxation. See 99 Cong. Rec. 7259 (1953) (remarks of Sen. Daniel).

[39] See *Atlantic Richfield Co.* v. *Alaska*, 705 P.2d 418 (Alaska 1985), appeal dismissed, 106 S.Ct. 774 (1986) (Burger, C.J., and White and Stevens, JJ., dissenting):

Whatever the differences may be under the Internal Revenue Code (see U.S. Am. Br. 16), there are no differences, for purposes of the OCSLA, among sales of OCS production to a third party on the Shelf, sales to a related corporation on the Shelf, or (as occurred in this case) internal corporate transfers on the Shelf for later sale to third parties on the mainland. Even viewing the question through the distorting prism of the tax code, the Solicitor General recognizes (*ibid.*) that there is a "nonfrivolous argument that the policies of the Outer Continental Shelf Lands Act would not be furthered by such formal distinctions"; viewed through the proper prism of the OCSLA, the argument against such formal distinctions becomes compelling. If, as demonstrated above and as the Solicitor General acknowledges, the OCSLA prohibits states from taxing the value of OCS production sold on the Shelf, it also prohibits state taxation of the value of OCS production in connection with sales off the Shelf.

B. The Court Should Grant Review In This Case And Hold The Florida Case

For the reasons discussed above, plenary review of the Iowa Supreme Court's decision is fully warranted. The Iowa appeal includes the issue raised in the Florida case concerning state taxation of OCS production sold off the Shelf, as well as the additional issue of taxation of OCS production sold on the Shelf. Both issues should be decided by this Court, and this case—but not the Florida case—provides an opportunity to do so. Moreover, the factual record in this case was stipulated by the parties and therefore is especially manageable and useful in illuminating the legal issues presented.

Obviously, profits do not result from * * * oil production until the product is sold. This does not negate the fact that profits generated by the sale are partly attributable to the inherent value of the * * * oil at its point of production.

705 P.2d at 425.

Accordingly, because this appeal provides a far better vehicle for definitively resolving the issues presented in these cases, and because the Court's decision in the Iowa case also will control the Florida case, we suggest that the Court should note probable jurisdiction here and hold the Florida case for disposition in light of the Court's decision in this case.

CONCLUSION

Probable jurisdiction should be noted.

Respectfully submitted.

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DECEMBER 1987

APPENDICES

APPENDIX A

IN THE SUPREME COURT OF IOWA

[Filed October 21, 1987]

KELLY-SPRINGFIELD TIRE CO.,
Appellant,

vs.

IOWA STATE BOARD OF TAX REVIEW,
Appellee.

SHELL OIL COMPANY,
Appellant,

vs.

THE IOWA DEPARTMENT OF REVENUE,
Appellee.

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87-278
86-1565

Appeals from the Iowa District Court for Polk County, J. P. Denato and Joel D. Novak, Judges.

Consolidated appeals by corporate taxpayers in actions for judicial review of assessments of additional income taxes by Iowa Department of Revenue. (NO. 87-278) REVERSED AND REMANDED; (NO. 86-1565) AFFIRMED IN PART, REVERSED IN PART AND REMANDED.

Considered en banc.

CARTER, J.

These consolidated appeals raise two legal issues in regard to income tax assessments by the Iowa Department of Revenue (IDOR) being judicially reviewed under Iowa Code section 17A.19 (1985). These issues are: (1) whether assessment of additional corporation income taxes by IDOR against appellant Kelly-Springfield Tire Co. (Kelly-Springfield) in No. 87-278 and appellant Shell Oil Company (Shell) in No. 86-1565, made more than three years after the filing of the taxpayers' returns, was untimely under Iowa Code section 422.25(1) (1977) and therefore invalid; and (2) whether assessment of additional income taxes against Shell in No. 86-1565 was in violation of the Outer Continental Shelf Lands Act (OCSLA), 43 U.S.C. § 1333(a). For reasons hereafter stated, we answer the first question in the affirmative and the second question in the negative, thus, affirming in part and reversing in part the decisions of the district court.

I. *Timeliness of Assessments Under Iowa Code Section 422.25(1) (1977).*

The record supports the taxpayers' contention that assessment of additional corporate income taxes by IDOR against Kelly-Springfield for the years 1971-78, inclusive, and against Shell for the years 1975-77, inclusive, were initiated more than three years after those taxpayers had filed corporate income tax returns for the years in question. Consequently, both Kelly-Springfield and Shell have contended both before the agency and throughout these judicial review proceedings that these assessments were untimely under Iowa Code section 422.25(1) (1977) and thus invalid.

Section 422.25(1) provides:

> As soon as practicable and in any event within three years after the return is filed the department shall examine it and determine the correct amount of tax, and the amount so determined by the department shall be the tax; provided that if the taxpayer omits from income such an amount as will, under the Internal Revenue Code of 1954, extend the statute of limitations for assessment of federal tax to six years under said Code, the period for examination and determination shall be six years; and provided further that the period for examination and determination shall be unlimited in the case of a false or fraudulent return with intent to evade tax or in the case of failure to file a return. Notwithstanding the periods of limitation for examination and determination heretofore specified, the department shall have six months to make an examination and determination from the date of receipt by the department of notice from the taxpayer of the final disposition of any matter between the taxpayer and the internal revenue service with respect to the particular tax year.

For each of the tax years in controversy, the Internal Revenue Service (IRS) had audited the taxpayers' returns. The additional assessments of Iowa income taxes were made within six months of receipt by IDOR of notice of the final disposition of the federal audit for the particular tax year. These additional assessments of Iowa income taxes, except for certain adjustments in Kelly-Springfield's tax liability for 1971, were unrelated to and not affected by any changes made in connection with the audit of the taxpayers' federal income tax liabilities.

The issue which was framed at the contested case hearing was whether IDOR's right of examination and determination of additional state tax liability during the extended six-month period following the conclusion of a federal audit is unlimited in scope or is limited to corrections resulting from action taken in the federal audit.

Following the contested case hearing, IDOR concluded that its right of examination and determination for six months following a federal audit is unlimited in scope. The district court agreed with that conclusion.

The primary argument advanced by IDOR to sustain its interpretation is that the words "examination and determination," which appear several times within section 422.25(1), are in no instance qualified with respect to the scope of the inquiry IDOR is permitted to make. Because the scope of the examination and assessment of additional tax is concededly unlimited in the other circumstances where the phrase "examination and determination" appears in the statute, IDOR argues that consistency in the application of identical statutory language requires an unlimited examination also be permitted in the present situation.

In response to this argument, the taxpayers urge that an exception to a general period of limitation which is triggered by the occurrence of a particular event must be interpreted in some manner which is relevant to that event. The mere occurrence of a federal audit is not, taxpayers argue, relevant to whether the limitation period for imposing state tax liability should be extended. It only becomes relevant, they suggest, if action taken in the federal audit alters some basic premise on which the taxpayer's state tax liability was initially reported.

We find the taxpayers' interpretation to be more plausible than the one proposed by IDOR. A court construing a statute to ascertain legislative intent must not only consider the language used, but must also take account of the object sought to be accomplished or the problems sought to be remedied and arrive at a construction that will best effect its purpose. *Matter of Girdler*, 357 N.W.2d 595, 597 (Iowa 1984); *In Interest of G.R.*, 348 N.W.2d 627, 631 (Iowa 1984); *Lau v. City of Oelwein*, 336 N.W.2d 202, 203 (Iowa 1983).

The extended period of examination following the conclusion of a federal audit was inserted in section 422.25 (1) by 1957 Iowa Acts chapter 211, section 1. The determination of the primary objective of such an amendment requires reference to the prior state of the law and the circumstances surrounding the amendment's enactment. *City of Des Moines v. Public Employment Relations Bd.*, 275 N.W.2d 753, 760 (Iowa 1979). Applying these principles to the present case it appears that, prior to the enactment of the 1957 amendment, it was established as the legislative policy of this state that examination and determination of the proper amount of tax was to be made by IDOR within three years of the filing of the taxpayer's return except in certain situations of taxpayer omission not relevant here.[1] The interpretation proposed by IDOR is, we believe, incompatible with the basic premise upon which section 422.25(1) is based, *i.e.*, that unless certain enumerated circumstances have occurred which preclude the agency from making an accurate assessment of Iowa taxes within the three-year period its right of examination is barred.

We find nothing in the 1957 amendment which suggests a retreat from this overriding policy. Rather, the federal audit exception to the three-year limitation appears to be a fair way of dealing with changed circumstances resulting from the federal examination. The exception is therefore available to IDOR only if adjustments made by the internal revenue service create a change of circumstances affecting the taxpayer's Iowa tax liability. The rather short period of time granted IDOR to make adjustments of Iowa tax liability following the conclusion of the fed-

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[1] This policy has existed for more than 50 years. Beginning in 1934, the limitation period was established at two years. 1934 Iowa Acts ch. 82, § 21 (45 Ex. G.A.). It was increased to three years in 1955. 1955 Iowa Acts ch. 210, § 1.

eral inquiry supports our conclusion that the examination is limited in scope.[2]

In *Commonwealth v. Lukens Steel Co.*, 402 Pa. 304, 167 A.2d 142 (1961), the court interpreted a Pennsylvania statute which provided that,

> [I]f at any time the net income as returned by any corporation to the federal government is finally changed or corrected by the commissioner of internal revenue or by any other agency or court of the United States with a result that tax, in addition to the amount paid, is due under this act, the department is hereby authorized and empowered to make a resettlement of the tax due by such corporation, based upon the facts contained in the report, or upon any information within its possession or that shall come into its possession.

Pa. Stat. Ann. Tit. 72, § 3402h(c) (Purdon 1964). Notwithstanding the rather broad language in the final sentence of the statute, the court reasoned that its legal effect was to extend the limitation period only for purposes of making assessments of state income taxes due as a result of federal adjustments. The court indicated a contrary ruling would render absolutely meaningless the provisions of the act establishing a general time limit for resettlement. 402 Pa. at 309-10, 167 A.2d at 145. *See also McLean Trucking Co. v. Lindley*, 70 Ohio St. 2d 106, 111, 435 N.E.2d 414, 417 (1982) (general limitation period absolute bar to assessment of additional state

[2] Another factor which suggests that the legislature intended a limited scope of examination is that legislative enactments contained in 1955 Iowa Acts ch. 210, § 2, which shifted to the state the burden of proof in areas where the right of examination is unlimited, were not made applicable to the extended period of examination following a federal audit. This suggests a legislative intent that the factual basis for reexamination of Iowa tax liability in the latter situation would turn on the result of the federal audit and not involve other areas of disputed fact.

taxes unrelated to corrections made by internal revenue service).

IDOR argues that, notwithstanding the matters which we have discussed, its long-standing interpretation of the statute should be given some weight. Although the interpretation of the statute proposed by IDOR in the present case may have been the department's position for some time, it should be noted that it has issued no published rule or directive codifying that position. As we have stated in another revenue case involving statutory interpretation, "the meaning of a statute is always a matter of law, and final construction and interpretation . . . is for this court." *Sorg v. Iowa Dep't of Revenue*, 269 N.W.2d 129, 131 (Iowa 1978). *See also City of Des Moines*, 275 N.W.2d at 759-60. We hold that any adjustment by IDOR to the taxpayers' liability in the present cases which was not initiated within three years following the filing of returns was untimely and invalid except as it relates to changes required by the federal audit. This requires a reversal of No. 87-278 and a reversal of No. 86-1565 on this issue.

II. *Claims Involving Taxation of Revenues Derived From Outer Continental Shelf Lands.*

The next issue, involving only claims by Shell in No. 86-1565, concerns an alleged limitation on the power of the states to tax activities occurring on outer continental shelf (OCS) lands which Shell suggests is contained in the Outer Continental Shelf Lands Act, 43 U.S.C. section 1333(a).

The record reflects that Shell is a Delaware corporation engaged in a unitary business consisting of exploration for oil and the development, production, transportation, purchase and marketing of crude oil, natural gas, and chemical products. During the years at issue, certain of Shell's gross revenues were derived from sale of products extracted from OCS lands. During this period, Shell sold

all of its OCS natural gas at the platform on OCS lands. In contrast, most of Shell's crude oil was transferred off OCS lands to other locations prior to being marketed. Shell's principal business in Iowa during this period consisted of marketing oil and chemical products which had been refined and manufactured outside Iowa.

In accordance with Iowa Code section 422.33(2)(b)(4), Shell's Iowa net income was derived by application of an apportionment formula wherein "the part attributable to business within the state shall be in that proportion which the gross sales made within the state bear to the total gross sales." Because its gross revenues for these years contained amounts realized from the disposition of OCS products, Shell maintains that it was improper for the state of Iowa to give any consideration to revenue from OCS sources in the application of the statutory apportionment formula utilized to determine its Iowa income tax liability.

In advancing this argument, Shell relies upon language contained in subparagraphs 2(A) and (3) of section 1333(a) of the OCSLA, which provides, in part, as follows:

> (2)(A) To the extent that they are applicable and not inconsistent with this subchapter or with other Federal laws and regulations of the Secretary now in effect or hereafter adopted, the civil and criminal laws of each adjacent State, now in effect or hereafter adopted, amended, or repealed are hereby declared to be the law of the United States for that portion of the subsoil and seabed of the outer Continental Shelf, and artificial islands and fixed structures erected thereon, which would be within the area of the State if its boundaries were extended seaward to the outer margin of the outer Continental Shelf, and the President shall determine and publish in the Federal Register such projected lines

> extending seaward and defining each such area. All of the applicable laws shall be administered and enforced by the appropriate officers and courts of the United States. *State taxation laws shall not apply to the outer Continental Shelf. . . .*
>
> (3) The provisions of this section for adoption of State law as the law of the United States shall never be interpreted as a basis for claiming any interest in or jurisdiction on behalf of any State for any purpose over the seabed and subsoil of the outer Continental Shelf, *or the property and natural resources thereof or the revenues therefrom.*

(Emphasis added.) Shell views the foregoing statutes as a Congressional directive designating any return from its OCS land transactions as federally protected income and, therefore, not includable in the Iowa tax base. In so arguing, it relies upon the decisions of *Aloha Airlines, Inc. v. Director of Taxation of Hawaii*, 464 U.S. 7, 104 S. Ct. 291, 78 L. Ed. 2d 10 (1983), and *Ramah Navajo School Board, Inc. v. Bureau of Revenue of New Mexico*, 458 U.S. 832, 103 S. Ct. 3394, 73 L. Ed. 2d 1194 (1982).

We do not agree that these cases support Shell's contentions. The policies underlying the federal legislation applied in the *Aloha Airlines* and *Ramah Navajo School Board* cases were clearly indicated to be such that the application of local taxing statutes would have undeniably frustrated the goals which Congress was attempting to promote. In contrast, Shell has indicated no particular area of Congressional policy in the management and control of the OCS lands which is frustrated by the state of Iowa applying a traditional measure of apportionment in order to obtain a valid local nexus for taxation purposes.[3]

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[3] In defining the term "unitary business" for purposes of apportioning income, Iowa Code § 422.32(5) refers to a business carried on partly within and partly without a state where the portion of

The issue is, of course, entirely one of statutory interpretation. The Florida Supreme Court in *Shell Oil Co. v. Department of Revenue*, 496 So. 2d 789, 791 (Fla. 1986), has rejected the interpretation which Shell seeks to place on 43 U.S.C. sections 1333(a)(2)(A), (3). In that case, the court concluded that the realization of the income by Shell occurred within the legislative jurisdiction of the taxing state. The facts of the present case differ slightly from those in the cited case because the Florida revenue officials had excluded from their apportionment formula that portion of Shell's gross revenues which were derived from sales made on OCS lands. In the present case, Iowa has apparently included in its gross apportionment formula some revenues derived by Shell from the sale of natural gas at the platform on the OCS. We do not believe, however, that this distinction warrants a result in the present case which differs from the one reached by the Florida court.

In reviewing the legislative history of the OCSLA, we are convinced that the language restricting the application of state taxation laws to the OCS and denying to the state any interest in the natural resources or revenues from the seabed and subsoil of the OCS was intended as a limitation on the authority of states adjacent to OCS lands to extend legislative jurisdiction to the OCS. The legislation in question was the culmination of an historical tug-of-war between state and federal interests in the region. In a pertinent report on the legislation by the Senate committee, it was stated:

> It is the Committee's collective judgment that under the terms S. 1901 as reported, State taxation laws

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the business carried on within the state depends on or contributes to the business outside the state. Section 432.32(10) defines "State" so as to include "any territory or possession of the United States." We conclude that the OCS lands are a territory of the United States so as to be includable within this definition.

> necessarily are excluded from applicability in this area of exclusive Federal jurisdiction not inside the boundaries of any state. Paragraph (3) of Section 4(a) specifically commands that—
>
> > The provisions of this section for adoption of the State law as the law of the United States shall never be interpreted as a basis for claiming any interest in or jurisdiction on behalf of any state for any purpose over the seabed and subsoil of the outer Continental Shelf, or the property and natural resources thereof or the revenues therefrom.
>
> S. Rep. No. 411, 83rd Cong., 1st Sess. (1953).

Iowa's imposition of the challenged corporation income taxes on Shell for the years 1975-80, inclusive, is in no way dependent upon the exercise of legislative jurisdiction on OCS lands. Its taxing jurisdiction depends instead on the nexus of Shell's activities within this state. The inclusion of some OCS revenues in the apportionment formula is simply a method of obtaining an acceptable measure of the local nexus.[4] This principle was illustrated in *Moorman Manufacturing Co. v. Bair*, 254 N.W.2d 737 (Iowa 1977), *aff'd*, 437 U.S. 267 (1978). In further amplifying the principles established in its affirming opinion in *Moorman*, the Supreme Court stated in *Mobile Oil Corp. v. Commissioner of Taxes*, 445 U.S. 425, 100 S. Ct. 1223, 63 L. Ed. 2d 510 (1980):

> "[T]he entire net income of a corporation generated by interstate as well as intrastate activities, may be fairly apportioned among the States for tax purposes

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[4] In this regard, the nature of the tax differs substantially from the "first-use" tax involved in *Maryland v. Louisiana*, 451 U.S. 725, 101 S. Ct. 2114, 68 L. Ed. 2d 576 (1981). Shell's reliance on that case is also misplaced because it was not decided under the OCSLA but instead involved the Natural Gas Policy Act.

> by formulas utilizing in-state aspects of interstate affairs." [citing *Moorman Mfg. Co. v. Bair*, 437 U.S. 267, 272-73, 98 S. Ct. 2340, 2344, 57 L. Ed. 2d 197, 204 (1978)] . . . The requisite "nexus" is supplied if the corporation avails itself of the "substantial privilege of carrying on business" within the State, and "[t]he fact that a tax is contingent upon events brought to pass without a state does not destroy the nexus between such a tax and transactions within a state for which the tax is an exaction."

Id. at 436-37, 100 S. Ct. at 1231, 63 L. Ed. 2d at 520 (other citations omitted).

Shell's argument that somehow the source of the revenues prohibits their inclusion in the apportionment formula is only valid if it was the intent of Congress to prohibit that result. In seeking to determine that intent, we begin with the recognition that the pattern of apportionment of gross revenues, regardless of source, for purposes of determining local taxability is well established within our federal system. As observed in *Mobile Oil Corp.*:

> In the past, apportionability often has been challenged by the contention that income earned in one State may not be taxed in another if the source of the income may be ascertained by separate geographical accounting. The Court has rejected that contention so long as the intrastate and extrastate activities formed part of a single unitary business. . . . In these circumstances, the Court has noted that separate accounting, while it purports to isolate portions of income received in various States, may fail to account for contributions to income resulting from functional integration, centralization of management, and economies of scale. . . . Because these factors of profitability arise from the operation of the business as a whole, it becomes misleading to characterize

> the income of the business as having a single identifiable "source." Although separate geographical accounting may be useful for internal auditing, for purposes of state taxation it is not constitutionally required.

Id. at 438, 100 S. Ct. at 1232, 63 L. Ed. 2d at 521 (citations omitted).

In deciding whether Iowa's taxing statutes offend against Congressional policies of management and control of OCS lands, it is preferable, we believe, to focus on the tax consequences which are produced by applying the apportionment formula rather than focusing on the various elements which are inserted into the equation in order to produce those consequences. Shell's argument fails to indicate how the impact of applying the apportionment formula detracts in any identifiable way from Congressional policy relating to OCS lands.

The inclusion of OCS revenues in gross sales for purposes of applying the statutory apportionment formula contained in Iowa Code section 422.33(2)(b)(4) apparently aids in obtaining an accurate measure of the tax to be imposed as a result of Shell's Iowa activities.[5] That, of course, is the goal of any apportionment formula. We cannot attribute to Congress an intent to impede this legitimate goal in the absence of some compelling indication that such was its intention in passing the OCSLA. We fail to divine any such intention from either the legislative history or language of the Act. We conclude that the district court properly rejected Shell's petition for judicial review on this issue.

Based upon our determination of the issues presented, the judgment of the district court in No. 87-278 is reversed and that case is remanded to the agency for further proceedings not inconsistent with this opinion. The

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[5] See n.3, *supra*.

judgment of the district court in No. 86-1565 is in all respects affirmed on the issues involving application of 43 U.S.C. section 1333(a) and is reversed on the issues involving the application of Iowa Code section 422.25(1). As to the latter issues, the case is remanded to the agency for further proceedings not inconsistent with this opinion. The costs of appeal in No. 87-278 are taxed to appellee. The costs of appeal in No. 86-1565 are taxed seventy-five percent to appellant and twenty-five percent to appellee.

(NO. 87-278) REVERSED AND REMANDED; (NO. 86-1565) AFFIRMED IN PART, REVERSED IN PART AND REMANDED.

All justices concur except Snell, J., who takes no part.

APPENDIX B

IN THE IOWA DISTRICT COURT FOR POLK COUNTY

No. AA 952
RULING

SHELL OIL COMPANY,
Petitioner,

vs.

THE IOWA DEPARTMENT OF REVENUE,
Respondent.

[Filed Oct. 3, 1986]

This matter came on before the Court on June 27, 1986 upon the Petition for Judicial Review of the decision of the Iowa Department of Revenue (hereinafter "the Department"). Petitioner (hereinafter "Shell" or "Shell Oil") was represented by William Peltz, General Tax attorney, Shell Oil Company, and attorney James W. Hall. The Department was represented by Harry M. Greiger, Special Assistant Attorney General. After reviewing the record, briefs and having considered the statements and arguments of counsel, the Court makes the following ruling.

STATEMENT OF THE CASE

The Court has jurisdiction over the subject matter of this action and over the parties hereto. This is an application for judicial review of an adverse decision in a con-

tested case after all administrative remedies have been exhausted.

The parties filed a stipulation prior to the administrative hearing. The stipulation, after deletion of nonfactual material, arguments and controverted material, was adopted by the hearing officer as part of the Findings of Fact. This Court adopts and fully incorporates the Findings of Fact of the parties stipulation in its entirety, as well as Findings of Fact Nos. 47 through 51 of the Hearing Officer's Order. The relevant portions of the adopted and incorporated Findings of Fact are set out below:

STIPULATION

I

GENERAL DESCRIPTION OF SHELL OIL COMPANY

1. Shell Oil Company ("Shell") is a Delaware corporation with business operations in all fifty states and the District of Columbia.

2. During the years 1975 through 1980, Shell was the parent member of an affiliated group of corporations, the principal business of which is the exploration for, and development, production, transportation, purchase, and marketing of crude oil and natural gas, and the purchase, manufacture, and marketing of oil and chemical products. Shell is a vertically integrated oil company which itself engages in the business activities set out above and also set forth in paragraph 4(b)(1) of the Protest and in Shell's annual 10K reports, Exhibits A, B, C, D, E, and F.

3. During the years 1975 through 1980 Shell Oil Company conducted the majority of its business activities as two separate operating organizations, the Products Organization and the Exploration and Production (E&P) Organization. . . . The E&P Organization is responsible for locating and acquiring rights to develop and produce crude oil, gas, and other natural resources. The production resulting from E&P Organization's activities is Shell's major single supply of raw material. The Products Organization is responsible for the transportation, purchasing, and marketing of crude oil and natural gas liquids, and the manufacture and marketing of petroleum and chemical products. The Products Organization's products are refined and manufactured from feedstock (crude oil and natural gas) obtained from the E&P Organization or purchased from others. The Products Organization does not perform any funetions on the Outer Continental Shelf (OCS).

4. The Products Organization has two major operating segments; Oil Products and Chemical Products. . . . The Products Organization obtains part of its crude oil requirements from Shell's E&P Organization to Shell's Products Organization, the transfers were recorded by Shell as sales at posted industry prices with appropriate adjustments for gravity and transportation, but no money was paid for such intracompany transfers. Such transfers at posted industry prices involved crude oil production in the OCS and non-OCS areas. See paragraph 23, *infra*. During the years 1975 through 1980 Shell was a "net purchaser" of crude oil, its E&P Organization provided from a law of 48.6 percent of the Products Organization's crude oil in 1977 to a high of 60.7 percent in 1980. The balance of Shell's crude oil requirements was acquired by way of purchase by the Products Organization. Such purchases included purchases from domestic sources (including purchases from other OCS producers) and from foreign sources.

5. . . . .

6. During 1975-80, within the State of Iowa, Shell's principal business consisted of marketing oil and chemical products refined and manufactured by the Products Organization. There were crude oil based Shell-manufactured products sold in Iowa which were manufactured from

crude oil which was commingled to the extent that the ultimate source (OCS or non-OCS) of the crude oil could not be determined with any degree of certainty. . . .

7. Shell's activities as described in paragraph 2 of this Stipulation, including its activities on the OCS, constitute a unitary business, a portion of which, as stated in paragraph 6, was carried on within the state of Iowa during the years 1975 through 1980. Shell's activities are substantially similar to those described in the case of *Exxon Corp. v. Wisconsin Dept. of Revenue*, 447 U.S. 207 (1980).

II

OUTER CONTINENTAL SHELF OPERATIONS

AREA INVOLVED

8. Under the Outer Continental Shelf Lands Act (OCSLA), 43 U.S.C. § 1331, *et seq.*, the Outer Continental Shelf (OCS) is defined as "all submerged lands lying seaward and outside the area of lands beneath navigable waters as defined in Section 1301 of this title, and of which the subsoil and seabed appertain to the United States and are subject to its jurisdiction and control" 43 U.S.C. 1331(a). Section 1301 of title 43 U.S.C. is part of the Submerged Lands Act (43 U.S.C. 1391 *et seq.*) and defines "land beneath navigable waters" as essentially that area within three miles of the coast line of the United States. (Texas owns 3 marine leagues into the Gulf of Mexico.) In short, the Outer Continental Shelf is the submerged land, as defined in 43 U.S.C. § 1331(a), which lies beyond the 3-mile limit. Rather than being a geographic feature, as would be inferred from its name, the OCS is a legal term describing the land extending seaward from a state's offshore boundary under water over which the United States claims economic or territorial jurisdiction. As such the OCS is not located in the State of Iowa or any other of the 50 states,

so during 1975 through 1980 the actual extraction of OCS minerals did not occur in Iowa or any of the other 50 states. The OCS surrounds the continental 48 states, Alaska and Hawaii.

9. The rights to explore for, develop and produce hydrocarbons (oil and gas) from beneath the OCS were conveyed by the federal government to private enterprises by way of lease sales. During the years at issue specific tracts of OCS land were selected to be the subjects of lease sales. The size of these tracts ranged from 750,000 to 1 million acres and the leases were usually in 5,000 or 5,760 acre blocks. The lease sale was advertised in the Federal Register at least 30 days before the sale with the sale date, place and time, the tracts to be offered, and the royalty amount (usually 1/6) set by the government. . . .

The successful bidder received an oil and gas lease pursuant to the terms advertised in the announcement of the sale. Generally, the terms of the lease provided for a 1/6 royalty and gave the successful bidder the exclusive right to explore, develop, and produce petroleum from beneath the area awarded. The initial term (that time period during which actual extraction of gas or oil must begin) was usually five years. There was generally a rental provision of $3 per acre per year. Rent was to be paid each year in advance during the initial five year period or until the start of production; after production started the rent would be paid in the form of a royalty based on production.

The term of the lease was to run for as long as there was production; absent production the lease would expire at the end of the five year initial term. The lease would of course terminate on abandonment or surrender by the leasee. Upon termination of the lease for any reason, the structures built thereon were to be removed and any

wells to be plugged and abandoned in accordance with government regulations.

. . .

Shell has onshore leases or owns land from which it extracts oil and gas which is not part of the OCS. Shell was and is constantly exploring for oil and gas in non-OCS areas.

(Paragraphs 10 through 20 omitted.)

21. Test facilities are maintained in the OCS to ensure the quality of the crude oil delivered to the pipeline operator. And, of course, metering facilities are necessary to determine how much product is delivered to the pipeline operator. The pipeline servicing the platform may be owned by Shell or owned by an independent third party. Once the crude oil is in the pipeline it is transported to shore (continental United States) for delivery to a refinery or other manufacturing facility of either Shell or an unrelated refinery or manufacturer. The refined and manufactured products are marketed throughout the world. Most, but not all, of the crude oil extracted by Shell from the OCS wells was brought from the OCS to the continental United States. This crude oil was either refined in Shell's refineries in the continental United States, or was exchanged by Shell with other oil companies. The portion of that crude oil which was refined was either sold or exchanged. These exchanges were with other companies in the Petro-Chemical industry.

As is done with respect to crude oil, test facilities are maintained on the OCS to ensure the quality of a natural gas delivered to the pipeline operator, and metering equipment is used to measure the amount of natural gas transferred. All of Shell's OCS natural gas production is sold to pipeline companies at the producing platform on the OCS.

(Paragraphs 22 through 25 omitted.)

Shell files tax returns with every state (45 states and the District of Columbia) that has an income tax or a franchise tax measured by income. With the exception of Mississippi, Oklahoma, Alaska (for 1978-81). Iowa (for 1977-80) and Florida, Shell apportioned its net income to all other states (without deduction of its separately-computed OCS net income, all as computed by Shell pursuant to the procedures in Exhibit 7) on the basis of a three-factor formula. Shell, in filing state income tax returns, has never excluded its total OCS value of production from the pre-apportionment net income base pursuant to the procedures in Exhibit 7. Shell's factors for use in the three-factor formula in the years at issue are set out in Exhibit 9, attached hereto. Had Shell deducted its separately-computed OCS net income in the just-stated computation, Shell would have paid less tax in each of those states in each of the years at issue with the exception of 1978. [In 1978 the effect of the reduction of apportionable income by the amount of OCS net income would not have offset the increase in apportionable income caused by the increase in the apportionment formula percentage due to the removal of OCS property, payroll and sales from the apportionment factors.] Had Shell deducted its total OCS value of production it would have paid less tax in every year.

III

JURISDICTIONAL AND STATUTE OF LIMITATIONS FACTS

26. Shell keeps its books and records on the accrual method of accounting and its income is reported on a calendar year basis.

27. Shell timely filed Iowa Corporation Income Tax Returns, Forms IA 1120, for the years in issue as follows in accordance with extensions to file procured pursuant to Iowa Code Sections 422.21 and 422.38:

Taxable Year	Date Filed
1975	October 23, 1976
1976	October 18, 1977
1977	October 25, 1978
1977 amended	March 12, 1980
1978	October 30, 1979
1979	October 23, 1980
1980	October 27, 1981

28. During the period March 8, 1982, through approximately March 12, 1982, the Iowa Department of Revenue ("Department"), by and through its auditors, conducted a field audit of Shell's corporate income tax returns relating to calendar tax years 1975-80 inclusive.

29. On or about April 19, 1982, Shell received an unsigned document designated Notice of Adjustment and Deficiency For Corporation Income Tax, Form No. 96-051 (Notice of Adjustment). The Notice of Adjustment was dated April 15, 1982, and bore the account number 00007975003. The Notice of Adjustment reflected proposed additional tax amounts due or (refund due) as follows:

Taxable Year	Tax
1975	$ 143,345.90
1976	204,941.00
1977	43,129.46
1978	8,755.20
1979	(117,024.70)
1980	(40,110.50)
Total	$ 243,036.36

The above amounts are exclusive of interest.

30. Attached hereto as Exhibit 10 is a copy of the Notice of Assessment For Corporation Income Tax, Form No. 96-052 (Notice of Assessment), dated June 10, 1982,

which was received by Shell on or about June 14, 1982. The Notice of Assessment reflected additional Tax Amounts due for the periods 1975 through 1980 identical to those set out on the Notice of Adjustment referenced in paragraph (27) above.

31. On September 1, 1982, within the lawful 90 day period following the Department's issuance of the Notice of Assessment referenced in paragraph (28) above, Shell filed a written protest pursuant to Sections 422.28 and 422.41 of the Iowa Code setting forth its specific objections to the assessment.

32. The audit adjustments underlying the Department's assessment notification relate to the Department's interpretation of Iowa statutes, regulations and case law. None of the adjustments which are the subject of the assessment and this contested case proceeding are the result of any adjustment made in any audit by the Internal Revenue Service for any taxable year.

33. Shell and the Department have not entered into any waiver agreement authorized by Iowa Code Section 422.25(7).

34. The amount in controversy for each taxable year, to the parties' knowledge, does not fall within those items of gross income defined in the Internal Revenue Code of 1954, as amended, as will under that Code extend the statute of Limitations for Federal tax purposes to six years, as set forth in Iowa Code Section 422.25(1). Accordingly, to the parties' knowledge Shell's returns for years 1975, 1976 and 1977 could not be examined by the Department on the basis of a six year Statute of Limitations in Section 422.25(1) commencing from the time each such return was filed or became due, whichever time is later.

35. The amount in controversy for each taxable year is not, to the parties' knowledge derived from false or fraudulent returns made with the intent to evade tax.

36. The amount in controversy for each taxable year was not assessed because of either the carryback of net operating losses or of net capital losses. Shell had overpaid its estimated Iowa income taxes for 1979 and 1980.

37. Shell has not at any time relevant herein forwarded to the Iowa Department of Revenue a written notification concerning the final disposition of any matter or controversy existing between it and the Internal Revenue Service (IRS) with respect to any of the years in question, 1975-1977 inclusive. In addition, Shell has not sent to the Department a copy of any Federal document purporting to show the final disposition or final Federal adjustment for any of the years in question, 1975-1977 inclusive.

38. By execution of IRS Forms 872, the limitation of time for the assessment of any deficiency in Shell's reported liability for Federal income tax for the year 1975 was extended to March 31, 1980.

39. In March 27, 1980, Shell received a statutory notice of deficiency dated March 25, 1980, with respect to Shell's Federal income tax liability for 1975. This statutory notice of deficiency arose out of an audit by the IRS of Shell's 1975 Federal income tax return. The IRS made purported adjustments to Shell's Federal taxable income.

40. On August 11, 1980, Shell paid the liability stated on the March 25, 1980 Notice of Deficiency.

41. On February 23, 1981, Shell filed a claim for refund of the amount paid on August 11, 1980. As of the date that this stipulation is filed no final decision has been made by the IRS regarding that claim for refund.

42. On December 28, 1981, the IRS sent Notices of Deficiency to Shell setting out deficiencies in Shell's Federal income tax for the years 1976 and 1977. On or about March 26, 1982, Shell filed a petition in the United

States Tax Court (Docket No. 6784-82) for a redetermination of the deficiencies set forth in those Notices of Deficiency; the petition also claimed refunds for the years 1976 and 1977. As of even date no decision has been entered in that case. This statutory notice of deficiency arose out of an audit by the IRS of Shell's 1976 and 1977 Federal income tax returns. The IRS made purported adjustments to Shell's federal taxable income for years 1976 and 1977.

(Paragraphs 43 through 51 omitted.)

During the years 1975-80 Shell owned and operated crude oil gathering systems (pipelines) on the Outer Continental Shelf. Those systems were used to transport crude oil from production platforms owned by Shell and others on the OCS to common carrier pipelines which completed the transportation of the crude oil from the OCS to onshore distribution or processing points.

All of the crude oil transported in Shell's gathering system was owned or controlled by Shell at the time it entered the gathering system. Shell purchased or received on exchange the non-Shell produced crude oil prior to its entry into the Shell gathering system.

During 1975-80 the fees charged for the transportation of crude oil in Shell's gathering system were calculated to derive maximum economic benefit to Shell. However, due to government controls, fluctuations in production and unpredictable mechanical difficulties with the gathering system the net income earned by the gathering system varied from year to year.

CONCLUSIONS OF LAW

Shell raises two issues on review. The first is whether the Department's Notice of Assessment of June 10, 1982 results in the taxation of net income derived by Shell from the Outer Continental Shelf (OCS) in violation of the Outer Continental Shelf Lands Act (OCSLA) and the

Supremacy Clause of the United States Constitution. The second issue raised by Shell is whether the Department was required to make its assessment for additional tax against Shell for the years 1975, 1976 and 1977 within three years from the date Shell filed the respective tax returns.

OCSLA

Iowa Code § 422.33(1) provides, in pertinent part, as follows:

. . . . .

> 1. If the trade or business of the corporation is carried on entirely within the state, the tax shall be imposed on the entire net income, but if such trade or business is carried on partly within and partly without the state, the tax shall be imposed only on the portion of the net income reasonably attributable to the trade or business within the state, said net income attributable to the state to be determined as follows:
>
> b. . . . . .
>
> Where income is derived from the manufacture or sale of tangible personal property, the part thereof attributable to business within the state shall be in that proportion which the gross sales made within the state bear to the total gross sales.
>
> . . . . .

Section 422.33 establishes a "one factor" formula to determine the amount of a multistate corporation's net income which can reasonably be allocated to the State of Iowa for tax purposes. The one factor formula eliminates the property and payroll factors that previously were considered in the "three factor" formula. In *Moorman Mfg. Co. v. Bair*, 437 U.S. 267, 98 S.Ct. 2340, 57 L.Ed.2d 197 (1978), the Supreme Court upheld the constitutionality of Iowa's one factor formula for apportioning income.

The formula for calculating that portion of a multistate corporation's income subject to Iowa income tax under the one factor formula is as follows:

$$\frac{\text{Iowa Gross Sales}}{\text{Everywhere Gross Sales}} \times \text{Federal Taxable Income Adjusted Per Iowa Law} = \text{Iowa Income}$$

Shell does not contend that Iowa is prohibited from using a one-factor formula. Rather, Shell contends that the Outer Continental Shelf Lands Act requires that Iowa make adjustments to the one factor formula to exclude from state taxation any income Shell derives from its Outer Continental Shelf activities.

Shell calculated its Iowa taxable income for the years in dispute as follows:

$$\frac{\text{Iowa Gross Sales}}{\text{Everywhere Gross Sales} - \text{OCS Gross "Sales"}\ ^{1}} \times \text{Non OCS Taxable Income} = \text{Iowa Income}$$

Shell relies on the language of the Outer Continental Shelf Lands Act as authority for excluding its OCS income. The OCSLA provides, in pertinent part, as follows:

> 43 U.S.C. Section 1333(a)(1)
>
> The Constitution and laws and civil and political jurisdiction of the United States are hereby extended to the subsoil and seabed of the outer Continental

---

[1] Shell does not actually have any significant OCS "sales". Shell's OCS "sales" and "income" are derived from an internal accounting procedure which credits Shell's exploration and production division with "sales" at posted industry prices for transfers of oil and gas to Shell's Products division (Stip., par. 4). Only Shell's Product Division had Iowa activities (Stip., par. 6) and the Products Division is not involved in any activities on the OCS (Stip., par. 3)

Shell has commingled OCS and non-OCS oil to the extent that the ultimate source of the crude oil (OCS or non-OCS) for Shell manufactured products sold in Iowa could not be determined with any degree of certainty (Stip., par. 6).

Shelf and to all artificial islands, and all installations and other devices permanently or temporarily attached to the seabed, which may be erected thereon for the purpose of exploring for, developing, or producing resources therefrom, or any such installation or other device (other than a ship or vessel) for the purpose of transporting such resources, to the same extent as if the outer Continental shelf were an area of exclusive Federal jurisdiction located within a State: Provided, however, That mineral leases on the outer Continental Shelf shall be maintained or issued only under the provisions of this Act.

(2)(A) To the extent that they are applicable and not inconsistent with this Act or with other Federal laws and regulations of the Secretary now in effect or hereafter adopted, the civil and criminal laws of each adjacent State now in effect or hereafter adopted, amended, or repealed are hereby declared to be the law of the United States for that portion of the subsoil and seabed of the outer Continental Shelf, and artificial islands and fixed structures erected thereon, which would be within the area of the State if its boundaries were extended seaward to the outer margin of the outer Continental Shelf, and the President shall determine and publish in the Federal Register such projected lines extending seaward and defining each such area. All of such applicable laws shall be administered and enforced by the appropriate officers and courts of the United States. *State taxation laws shall not apply to the Outer Continental Shelf.*

(3) The provisions of this section for adoption of State law as the law of the United States shall never be interpreted as a basis for claiming any interest in or jurisdiction on behalf of any State for any purpose over the seabed and subsoil of the outer Continental Shelf, or the property and natural re-

sources thereof or the revenues therefrom. (Emphasis added.)

The Outer Continental Shelf is defined as "all submerged lands lying seaward and outside the area of lands beneath navigable waters as defined in Section 1301 of this title, and of which the subsoil and seabed appertain to the United States and are subject to its jurisdiction and control". 43 U.S.C. Section 1333(a). Rather than being a geographic feature, as would be inferred from its name, the OCS is a legal term describing the land extending seaward from a state's offshore boundary under water over which the United States claims economic or territorial jurisdiction. (Stip. par. 8).

The OCSLA, including the prohibition on state taxation, was enacted in 1953. Prior to 1977, Shell never made any deduction on its Iowa return for a separately calculated OCS net income. In fact, with the exception of recent OCS income deductions in four other states, Shell does not deduct separately-computed OCS net income for any of its income tax returns filed in other states (Stip., par. 25). If Shell were to ultimately prevail in its contention that the OCSLA prohibits any state tax law which uses OCS activities to attract tax (*see* Reply Brief of Petitioner, p. 25), then Shell has indeed discovered a dormant tax shelter of enormous proportions for the oil and gas industry, given the size of soil and gas reserves on the OCS.[2]

See Exhibit E, 1979 Shell Annual Report, p. 6 ("Shell believes the offshore has the nation's greatest potential

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[2] Shell currently is attacking Iowa's apportionment scheme for income tax purposes only. If Shell is correct in asserting that the products of OCS activities cannot be used by states to attract tax, then it follows that state sales and road use taxes on OCS oil and gas would likewise be prohibited. OCS oil and gas clearly would be the product attracting such taxes; a practice which Shell argues is prohibited by the OCSLA.

for large discoveries, and could produce 60 percent of the 60 billion barrels of new oil and 35 percent of the 315 trillion cubic feet of new gas we estimate remains to be found in the U.S.")

Shell has made numerous arguments supporting its contention that Iowa's apportionment scheme taxes Shell's OCS income. The Department does not concede that Iowa's single factor formula for apportioning income taxes any of Shell's OCS income or that Shell's "separate accounting" proves that Shell even had any OCS income. While there may be some merit to the Department's argument in this regard, it is not necessary for the Court to address these issues. For the reasons stated below, the OCSLA simply does not prohibit states from applying constitutionally permissible formula apportionment schemes to income derived from OCS activities.

The Outer Continental Shelf Lands Act was the culmination of a prolonged dispute between the federal government and states adjacent to the OCS over territorial jurisdiction and the right to lease submerged lands for oil and gas exploration. *See U.S. Code Cong. and Ad. News*, 1385-1640 (1953). Historically, states adjacent to submerged lands owned and exerted jurisdiction over the submerged lands, including the underlying oil, gas and mineral deposits. *U.S. Code Cong. and Ad. News*, 1497-98 (1953). Some states had extended their boundaries as far as the outer edge of the shelf. *Id.* at 1391. However, a series of Supreme Court decisions held that the federal government, not the states, had paramount right to submerged lands, even within the historic boundaries of the states of California, Louisiana, and Texas. *United States v. California*, 332 U.S. 19 (1947); *United States v. Louisiana*, 339 U.S. 699 (1950); and *United States v. Texas*, 339 U.S. 707 (1950).

It was in this context that the issue of state taxation of OCS activities arose. The OCSLA resolved the issue

of ownership of the OCS in favor of the federal government. The focus on taxation was exclusively on states adjacent to the OCS who might be able to defeat or frustrate the purpose of the OCSLA by asserting state police and taxation powers to OCS activities.

States adjacent to the OCS had attempted to include language in the act that would have allowed them to collect severance and production taxes. 99 Cong. Rec. at 2569 (1953). Senator Long of Louisiana argued that adjacent states needed to share in OCS revenue because services adjacent states provided to OCS workers would necessarily be paid from state treasuries. Senator Long's arguments failed and the final version of the OCSLA included the language that "State taxation laws shall not apply to the Outer Continental Shelf".

Nothing in the OCSLA or its legislative history can be construed as prohibiting states, either adjacent or inland, from fairly apportioning on income derived from sales in the taxing state. This is true even if the state's apportionment scheme indirectly results in taxation of income earned on the Outer Continental Shelf. What the OCSLA prohibits is an adjacent state (or states) enacting a severance, production or even an income tax on Shell Oils OCS operations. In other words, a coastal state cannot adopt Shell's separate accounting method for OCS "income" and then levy a tax on the entire amount, based upon some claim of territorial jurisdiction. However, the OCSLA does not prohibit the adjacent state from indirectly taxing some portion of OCS activities pursuant to a constitutionally permissible apportionment scheme related to Shell's sales in the taxing state. *Shell Oil Company v. Department of Revenue*, Nos. 66, 240 and 66, 254 (Fla. Sup. Ct., April, 1986).

As stated above, the OCSLA was primarily concerned with defining territorial jurisdiction and to quiet title as between adjacent states and the federal government as to

submerged lands. The OCSLA established boundary lines between state and federal domains. After enactment of the OCSLA, the OCS is clearly in the federal domain. 43 U.S.C. Section 1333(a)(3). Any taxation of the OCS by adjacent states would now be extraterritorial taxation, and it is extraterritorial taxation that is proscribed by the OCSLA. The issue then becomes whether Iowa's single factor apportionment scheme for unitary businesses results in extraterritorial taxation.

The Supreme Court has frequently considered whether state apportionment schemes result in constitutionally proscribed extraterritorial taxation. Most notably, the Court in *Moorman Manufacturing Company v. Bair*, 437 U.S. 267, 57 L.Ed. 2d 197, 98 S.Ct. 2340 (1978) upheld Iowa's single factor sales formula to apportion income. The Court held that Iowa's formula was reasonably related to Moorman's activities within the State of Iowa. The Court further held in *Exxon Corp. v. Wisconsin Dept. of Revenue*, 447 U.S. 207, 230, 65 L.Ed.2d 66, 100 S.Ct. 2109, 2123 (1980) that "that the geographic location of such raw materials (oil and gas) does not alter the fact that such income is part of a unitary business of the interstate enterprise and is subject to fair apportionment among all states to which there is a sufficient nexus with the business."

Shell contends that these cases are not instructive because they were decided on constitutional grounds, while Shell's OCS argument is based on statutory language. Even though the prohibition on state taxation of OCS activities is statutory, the OCSLA proscribes only extraterritorial taxation and is analogous to the constitutional proscription against extraterritorial taxation. Iowa's single factor sales formula does not result in extraterritorial taxation of income derived solely from Illinois operations. *Moorman, supra.* Likewise, Iowa's apportionment scheme does not tax income derived by Shell solely from the OCS. Rather, Iowa's indirect taxation of Shell's OCS income is directly attributable to Shell's sales within the State of Iowa.

Shell argues that the OCSLA's prohibition of state taxation was not meant to apply only to adjacent states and, even if Congress so intended, Congress could not have constitutionally denied adjacent states taxing powers that were allowed for interior states (Reply Brief of Petitioner, p. 21). Shell is correct in that the extraterritorial taxation proscribed by the OCSLA applies to all fifty states. As a practical matter, the prohibition on state taxation found in the OCSLA applies only to adjacent states. An inland state, such as Iowa, would appear rather foolish arguing that its territorial boundaries extend into the Atlantic or Pacific Ocean and that the state was not leasing submerged lands for oil and gas exploration, or, that it was imposing a severance tax on oil and gas removed from such territory. However, a coastal state, prior to the enactment of the OCSLA, could conceivably have made such a claim.

In short, the OCSLA prohibits extraterritorial taxation of the OCS by both inland and adjacent states. All states, inland or adjacent, are free to apply apportionment formulas which may indirectly tax OCS revenues, so long as the taxation is related to activities within the taxing state.

ADEQUACY OF NOTICE

Shell argues that the Department's June 10, 1982 Notice of Assessment of the years 1975, 1976 and 1977 was not timely. Therefore, Shell contends, the Department is precluded from assessing Shell with any additional tax liability.

Shell filed its 1975 Iowa tax return on October 28, 1976, filed its 1976 Iowa return on October 18, 1977 and filed its 1977 Iowa return on October 25, 1978 (Stip. par. 27). The assessment for additional Iowa income tax for

these years was issued by the Department on June 10, 1982 (Stip. par. 30).

Iowa Code Section 422.25(1) is applicable to this case. Section 422.25 was amended in 1981 in 1981 Iowa Acts, Ch. 135. 1981 Iowa Acts, Ch. 134, Section 2 provided that "this act is applicable for all tax years for which a final disposition of a taxpayer's federal income tax liability has not been resolved prior to the effective date of this act." Section 422.25(1) provides, in relevant part, as follows:

> 1. Within three years after the return is filed or within three years after the return became due, including any extensions of time for filing whichever time is the later, the department shall examine it and determine the correct amount of tax, and the amount determined by the department shall be the tax.
>
> . . .
>
> In addition to the applicable period of limitation for examination and determination, the department may make an examination and determination at any time within six months from the date of receipt by the department of written notice from the taxpayer and the internal revenue service with respect to the particular tax year.

Shell concedes that its federal tax return for 1975, 1976, and 1977 were the subject of a federal audit. (Stip. pars. 38-42). As of the date the Department's Notice of Assessment was sent to Shell, the dispute between Shell and the IRS for the returns in question had not been resolved (Stip. par. 41 and 42). Therefore, if the six month exception provided for in *Iowa Code* Section 422.25 applies, then the Department's Notice of Assessment to Shell was timely.

Shell argues that the six month exception of Section 422.25 does not apply where, as here, the Department's

assessment is not related to any adjustments made as a result of a federal audit. No such restriction is found in Section 422.25. The statutory language does not restrict the Department's audit of Shell's return to "federal" adjustments only.

The six month exception in Section 422.25 provides "In addition to the applicable period of limitation for examination and determination, the department may make an examination and determination at any time within six months . . . ." The "examination and determination" (or audit) referred to in the six month exception is the same "examination and determination" (or audit) which is allowed during the customary three year limitations period. There is no requirement in Section 422.25, as Shell contends, that the Department perform an initial audit of "state issues" during the three year limitations period and then perform a second audit or adjustment to the return after the federal audit is complete. The Court declines the invitation to impose a limitation period upon the Department that does not exist in the applicable statute.

ORDER

IT IS THEREFORE ORDERED, ADJUDGED AND DECREED that the Final Order entered on August 26, 1985 by the hearing officer in the above entitled matter is affirmed. Costs are taxed to the petitioner.

Dated this 3rd day of October, 1986.

/s/Joel D. Novak
JOEL D. NOVAK,
Judge
Fifth Judicial District of Iowa

APPENDIX C

BEFORE THE IOWA DEPARTMENT OF REVENUE
HOOVER STATE OFFICE BUILDING
DES MOINES, IOWA

DOCKET NO. 82-157-2A-A

IN THE MATTER OF

SHELL OIL COMPANY
One Shell Plaza
P.O. Box 2463
Houston, Texas 77001

CORPORATE INCOME TAX ASSESSMENT

ORDER OF DIRECTOR UPON REVIEW OF HEARING OFFICER'S PROPOSED ORDER

On September 23, 1985, the Iowa Department of Revenue (Department) filed an appeal to the Director of the Iowa Department of Revenue (Director), appealing the portion of the Hearing Officer's Proposed Order of August 26, 1985, which deleted paragraphs 22, 23, 24, and portions of paragraph 25 of the parties' Stipulation. On September 24, 1985, Shell Oil Company (Protestor) filed an appeal of the Hearing Officer's Proposed Order.

On October 4, 1985, the Director issued a Notice of Director's Review of Hearing Officer's Proposed Order, setting a review date of November 4, 1985. On October

14, 1985, the parties filed a Joint Agreement and Statement of Protestor and Department of Revenue.

The Director, having examined the record developed by the parties, hereby issues this Order.

STATEMENT OF THE CASE

The Director hereby adopts and fully incorporates into this Order the Statement of the Case as set forth in the Hearing Officer's Proposed Order.

FINDINGS OF FACT

The Director hereby adopts and fully incorporates as Findings of Fact the parties' Stipulation in its entirety. In addition the Findings of Fact numbered 47 through 51 in the Hearing Officer's Proposed Order are adopted and fully incorporated herein.

CONCLUSIONS OF LAW

The Director hereby adopts and fully incorporates into this Order the Conclusions of Law as set forth in the Hearing Officer's Proposed Order.

SUMMARY

The Director hereby adopts and fully incorporates into this Order the Summary as set forth in the Hearing Officer's Proposed Order.

IT IS THEREFORE ORDERED that the assessment of corporate income tax, interest, and fees as set out in the Notice of Assessment dated June 10, 1982, is affirmed. The Protestor failed to meet its burden of proof on the issues raised. With respect to the record developed by the parties, the evidence is more than substantial to support the factual and legal conclusions of this Order.

The Director's decision is the final Order of the Iowa Department of Revenue.

Issued at Des Moines, Iowa, this 4th day of December, 1985.

IOWA DEPARTMENT OF REVENUE

By /s/ G. D. Bair
G. D. BAIR
Director

APPENDIX D

BEFORE THE IOWA DEPARTMENT OF REVENUE
HOOVER STATE OFFICE BUILDING
DES MOINES, IOWA

DOCKET NO. 82-157-2A-A

IN THE MATTER OF

SHELL OIL COMPANY
One Shell Plaza
P.O. Box 2463
Houston, Texas 77001

CORPORATE INCOME TAX ASSESSMENT

PROPOSED ORDER

Pursuant to order of the undersigned Hearing Officer, this matter came on for evidentiary hearing before Orville Caruthers, Hearing Officer for the Iowa Department of Revenue, on December 12, 1984. Present at the hearing were James W. Hall, Attorney at Law and authorized representative for Shell Oil Company (hereinafter called "Protestor" or "Shell"); Thomas G. Singley, Assistant General Tax Counsel for Protestor; William D. Peltz, Senior Tax Counsel for Protestor; and Harry M. Griger, Special Assistant Attorney General for the State of Iowa and authorized representative for the Iowa Department of Revenue (hereinafter called the "Department"). The evidentiary hearing was reported by certified shorthand reporter Jill D. Stump.

STATEMENT OF THE CASE

The Protestor filed a protest in this matter on September 7, 1982, protesting the assessment of additional corporate income tax against Protestor. The Department

filed an Answer to that protest on May 5, 1983. A hearing officer for the Department issued a Notice of Time, Place and Nature of Hearing scheduling an evidentiary hearing on October 4, 1983. The authorized representative for the Department filed a Request for Prehearing Conference on June 3, 1983. A hearing officer for the Department issued a Notice of Prehearing Conference on June 22, 1983, scheduling a prehearing conference on July 25, 1983. Subsequently, the hearing officer for the Department continued the prehearing conference to October 4, 1983, and continued the evidentiary hearing to December 6, 1983. On September 21, 1983, an order was entered indefinitely continuing the prehearing conference. On November 10, 1983, an order was entered rescheduling the evidentiary hearing on May 23, 1984. On May 18, 1984, an Order for Continuance was entered rescheduling the evidentiary hearing on July 10, 1984. On June 19, 1984, an Order of Continuance was entered rescheduling the evidentiary hearing on September 10, 1984. On September 5, 1984, an order was entered rescheduling the evidentiary hearing on October 30, 1984. On October 12, 1984, an Order for Continuance was entered rescheduling the evidentiary hearing on December 12, 1984.

Protestor filed a Motion for an Order of Deletion on December 11, 1984; a Motion For Supplemental Order Of Deletion on May 31, 1985; and a Renewed Motion For Supplemental Order Of Deletion on July 2, 1985. See paragraphs 49 and 50 of the Summary (page 51 of this Proposed Order) for the resulting deletion orders.

The Protestor offered the following exhibits in evidence and these were received in evidence without objection from the authorized representative for the Department:

Exhibit 9: A copy of one page entitled "Shell Oil Company Iowa" showing figures for 1975 through 1980 for sales, payroll and property.

Exhibit 10: A copy of the Notice of Assessment issued to Shell Oil Company for corporation income tax for the years 1975 through 1980, bearing notice date of June 10, 1982.

Exhibit 11: An affidavit by Mason J. Neville consisting of three pages and dated December 7, 1984.

Exhibit 12: An affidavit of Steven C. Stryker consisting of eight pages, dated December 10, 1984.

At the evidentiary hearing on December 12, 1984, the following was offered as a supplement to Exhibit 12:

Mr. Stryker, the affiant in Exhibit 12, is a graduate of the University of Iowa. He graduated in 1967 with a bachelor's of science degree in sociology. He graduated from Iowa Law School in 1969 with a J.D. degree. He is a graduate of Northwestern University Graduate School of Business and received a certificate of professional accounting in 1969.

He became a CPA in Illinois in 1971 and was licensed as a Certified Public Accountant in Iowa in 1972. From 1968 through 1972 Mr. Stryker was employed by Arthur Young and Company as a senior tax accountant. From 1972 through 1973 he was employed by Massey-Ferguson in Des Moines. He was manager of Federal income tax, North American operations.

From 1973 through 1978 he worked for FMC and was manager of Federal and State taxes. From 1978 to the present he has been employed by Shell Oil Company in Houston. He is the general manager and assistant general tax counsel.

He is a member of the American Petroleum Institute and the Tax Executives Institute. He is a member of the American Bar Association. He is a member of the American Institute of Certified Pub-

lic Accountants. He is a member of the Iowa State Bar Association and a member of the Iowa Society of CPAs.

The Protestor offered the following Exhibits 1 through 8 and 13 in evidence. The Department objected to the reception of these nine exhibits in evidence on the grounds of relevancy. Based on the objection to "relevancy" without any further explanation or argument in support of the objection, and upon examination of Exhibits 1 through 8, the Hearing Officer concludes that he cannot determine, as of the time of submission of the case to the hearing officer, that all of Exhibits 1 through 8 are irrelevant to all of the issues in this matter, therefore, the objection as to Exhibits 1 through 8 is overruled and Exhibits 1 through 8 are received in evidence. Upon examination of Exhibit 13, the Hearing Officer comes to the same conclusion as on Exhibits 1 through 8 and, therefore, Exhibit 13 is received in evidence:

Exhibit 1: A copy of Shell Oil Company Exploration and Production Schedule E for 1975.

Exhibit 2: A copy of Shell Oil Company Exploration and Production Schedule E for 1976.

Exhibit 3: A copy of Shell Oil Company Exploration and Production Schedule E for 1977.

Exhibit 4: A copy of Shell Oil Company Exploration and Production Schedule E for 1978.

Exhibit 5: A copy of Shell Oil Company Exploration and Production Schedule E for 1979.

Exhibit 6: A copy of Shell Oil Company Exploration and Production Schedule E for 1980.

Exhibit 7: Consists of 12 pages entitled "Shell Oil Company Iowa Income Tax" for the years 1975 through 1980.

Exhibit 8: A copy of one page entitled "Shell Oil Company Iowa Income Tax Audit 1975-1980."

Exhibit 13: A copy of five pages of data making comparison with a cited case, with a "Iowa computation" and "Iowa income tax."

The following Exhibits were offered in evidenced by the Department and these were received in evidence without objection from the Protestor:

Exhibit A: A copy of form 10-K filed by Protestor for 1975.

Exhibit B: A copy of form 10-K filed by Protestor for 1976.

Exhibit C: A copy of form 10-K filed by Protestor for 1977.

Exhibit D: A copy of form 10-K filed by Protestor for 1978.

Exhibit E: A copy of form 10-K filed by Protestor for 1979.

Exhibit F: A copy of form 10-K filed by Protestor for 1980.

Exhibit G: A copy of the Corporation Income Tax Return for the State of Iowa filed by Protestor for the year 1975.

Exhibit H: A copy of the Corporation Income Tax Return for the State of Iowa filed by Protestor for the year 1976.

Exhibit I: A copy of the Iowa Corporation Income Tax Return and the Amended Iowa Corporation Income Tax Return filed by Protestor for 1977.

Exhibit J: A copy of the Iowa Corporation Income Tax Return filed by Protestor for 1978.

Exhibit K: A copy of the Iowa Corporation Income Tax Return filed by Protestor for 1979.

Exhibit L: A copy of the Iowa Corporation Income Tax Return filed by Protestor for 1980.

Exhibit N: An affidavit of John Christensen dated December 10, 1984, consisting of six pages.

Exhibit O: A copy of a Ruling on Special Appearance and Order, from the case of *Shell Oil Company v. G. D. Bair, Director, Iowa Department of Revenue*, no. CL04928706, in the Iowa District Court for Polk County.

Exhibit P: A copy of a Declaratory Ruling issued by the Department in the case of *In Re: The Petition of Shell Oil Company for a Declaratory Ruling on H.F. 2479*, bearing the Department's docket number 82-232-2A-DR, consisting of 13 pages.

The Department offered Exhibit M in evidence. The Protestor objected to the reception of Exhibit M in evidence on the grounds that it was irrelevant and on the further grounds that Exhibit M was written as a part of proposed settlement negotiations in a prior dispute of a similar nature and is therefore inadmissible into evidence in this case. The Department does not agree that Exhibit M was written as a part of any settlement negotiations and contends that an objection based on settlement negotiations is not grounds for exclusion of evidence under Iowa Code § 17A.14 and Department rule 730-7.17(2) IAC. Upon examination of Exhibit M, the Hearing Officer concludes that he cannot determine that all of Exhibit M is totally irrelevant. The Hearing Officer further concludes that the objection to Exhibit M on the grounds that it was written as a part of settlement negotiations is not a proper grounds for exclusion of evidence under the statute and rule cited by the Department. The following Exhibit M is received in evidence:

Exhibit M: A copy of a two-page letter from Protestor to the Department, dated September 10, 1980.

At the conclusion of the evidentiary hearing on December 12, 1984, the parties and the Hearing Officer agreed upon a briefing schedule. The Protestor was to file its brief within 60 days after the transcript was finished; the Department was to file its brief within 60 days after receipt of Protestor's brief; and the Protestor was to file its reply brief within 30 days following receipt of the Department's brief. An extension of time was granted to the parties and the Protestor's final brief was filed with the Department on July 2, 1985; the case was deemed submitted to the Hearing Officer for decision on that date.

FINDINGS OF FACT

The parties filed a *STIPULATION* in this matter on December 11, 1984. That stipulation provided that ". . . the following statements are made in lieu of oral testimony . . ." and ". . . either party may introduce other and further evidence not inconsistent with the facts herein stipulated . . .", therefore that *STIPULATION* is taken as a stipulation of testimony and evidence offered and not as a stipulation of facts to be incorporated in full. The *STIPULATION*, after deletions of non-factual material, arguments and controverted material, reads as follows and is adopted as a part of the Findings of Fact:

STIPULATION

IT IS HEREBY STIPULATED that for the purposes of this case the following statements are made in lieu of oral testimony and all exhibits referred to herein and attached hereto are incorporated in this stipulation and made a part thereof; provided, however, that either party may introduce other and further evidence not inconsistent with the facts herein stipulated and provided further that either party may object to statements and exhibits in this stipulation on grounds of relevancy.

STIPULATION

I

GENERAL DESCRIPTION OF SHELL OIL COMPANY

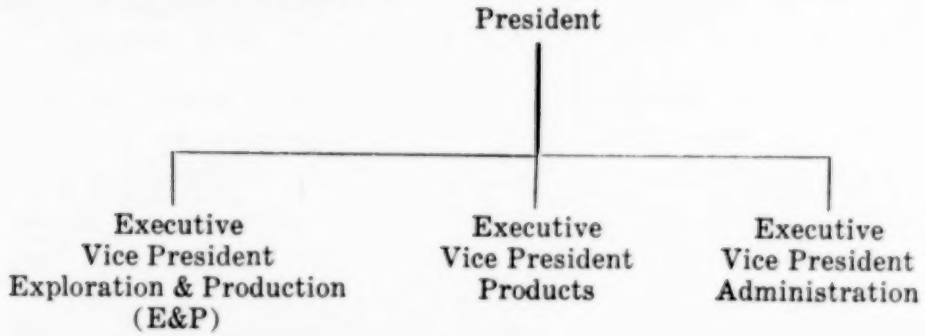
1. Shell Oil Company ("Shell") is a Delaware corporation with business operations in all fifty states and the District of Columbia.

2. During the years 1975 through 1980, Shell was the parent member of an affiliated group of corporations, the principal business of which is the exploration for, and development, production, transportation, purchase, and marketing of crude oil and natural gas, and the purchase, manufacture, and marketing of oil and chemical products. Shell is a vertically integrated oil company which itself engages in the business activities set out above and also set forth in paragraph 4(b)(1) of the Protest and in Shell's annual 10K reports, Exhibits A, B, C, D, E, and F.

3. During the years 1975 through 1980 Shell Oil Company conducted the majority of its business activities as two separate operating organizations, the Products Organization and the Exploration and Production (E&P) Organization. Management was headed by a President. The President is the Chief Executive Officer of the Company with responsibility for the general and active supervision and management of the property, affairs, and business of the Company. There are three Executive Vice Presidents. Two of them are responsible to the President for their respective operating organizations, the Products Organization and the E&P Organization; the third Executive Vice President is responsible to the President for the staff organizations such as Legal, Tax, Finance, Employee Relations, and administers those functions as they apply to the other two organizations (E&P and Products). The E&P Organization is responsible for locating and acquiring rights to develop and produce crude oil, gas,

and other natural resources. The production resulting from the E&P Organization's activities is Shell's major single supply of raw material. The Products Organization is responsible for the transportation, purchasing, and marketing of crude oil and natural gas liquids, and the manufacture and marketing of petroleum and chemical products. The Products Organization's products are refined and manufactured from feedstock (crude oil and natural gas) obtained from the E&P Organization or purchased from others. The Products Organization does not perform any functions on the Outer Continental Shelf (OCS).

The following is a diagram of the just-described portion of Shell's management which is located at Shell's offices in Houston, Texas.



4. The Products Organization has two major operating segments; Oil Products and Chemical Products; it is headed by an Executive Vice President. The Oil and the Chemical segments are each managed by a Vice President who has overall management responsibility for his business line and its sales function. There are three other segments of the Products Organization, the Operations and Technical segments which perform support functions; and the Special Projects segment which is responsible for special ventures involving the manufacture of selected petrochemical products in world-scale quantities. The Products Organization obtains part of its crude oil requirements from Shell's E&P Organization.

During 1975-80, for purposes of accounting for the transfers of crude oil production from Shell's E&P Organization to Shell's Products Organization, the transfers were recorded by Shell as sales at posted industry prices with appropriate adjustments for gravity * and transportation, but no money was paid for such intracompany transfers. Such transfers at posted industry prices involved crude oil production in the OCS and non-OCS areas. See paragraph 23, *infra*. During the years 1975 through 1980 Shell was a "net purchaser" of crude oil, its E&P Organization provided from a low of 48.6 percent of the Products Organization's crude oil in 1977 to a high of 60.7 percent in 1980. The balance of Shell's crude oil requirements was acquired by way of purchase by the Products Organization. Such purchases included purchases from domestic sources (including purchases from other OCS producers) and from foreign sources.

5. The E&P Organization has three operating segments; Domestic, International and Mining. During the years at issue the domestic oil and gas segment was divided geographically between Western Operations and Eastern Operations and contained five divisions. The Offshore Division was one of the five divisions and was part of Eastern Operations and it was through the Offshore Division that Shell's Outer Continental Shelf operations were conducted. One of the other four divisions was in Eastern Operations, the other three were in Western Operations; they had primary responsibility for exploration and production in non-OCS areas in the United States. The general manager of the Offshore Division and his staff located in New Orleans, Louisiana, conceived and executed operational plans and managed the existing

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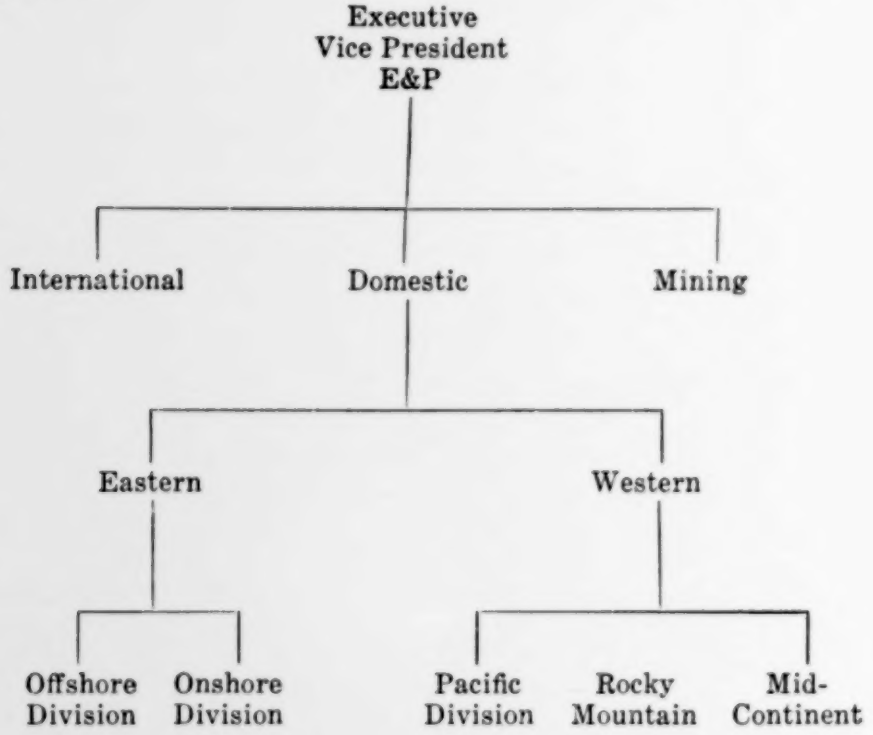
* Gravity of crude oil is measured on the A.P.I. (American Petroleum Institute) scale. The lighter in weight the oil, the greater the A.P.I. gravity. Most crude oils range from 27° to 35° A.P.I. Other factors being equal, the higher the A.P.I., the better price the oil will bring.

Shell assets on the Outer Continental Shelf (OCS). The general managers of the other divisions had similar responsibilities for, and exercised similar authority over, their respective divisions. The following is a diagram of the E&P Organization which represents the domestic segment.



The geographics areas covered by the various divisions were:

Offshore—Outer Continental Shelf;

Onshore—Connecticut
Delaware
Florida
Louisiana
Maine
Massachusetts
New Hampshire
New Jersey

Rhode Island
South Carolina
Vermont

Alabama, Southern 1/2
Arkansas, Southern 1/2
Georgia, except Northwest corner
Maryland, except Western panhandle
Mississippi, except Northeast corner
New York, Southern tip and Long Island only
North Carolina, Eastern 2/3
Pennsylvania, Southeast corner
Texas, South and East Texas
Virginia, East of Appalachians

Mid-Continent—Illinois
Indiana
Iowa
Kansas
Kentucky
Michigan
Minnesota
Missouri
Ohio
Oklahoma
Tennessee
West Virginia
Wisconsin

Alabama, Northern 1/2
Arkansas, Northern 1/2
Colorado, Southeast corner
Georgia, Northwest corner
Maryland, Western panhandle
Mississippi, Northeast corner
Nebraska, except Western portion
New Mexico, Southeastern 2/3

New York, except Southern tip and Long Island
North Carolina, Western 1/3
Pennsylvania, except Southeast corner
Texas, North and West Texas
Virginia, Western edge

Rocky Mountain—Arizona
Idaho
Montana
Nevada
North Dakota
South Dakota
Utah
Wyoming

Colorado, except Southeast corner
Nebraska, Western Portion
New Mexico, Northwestern 1/3
Oregon, except Western coastal region
Washington, except Western coastal region

Pacific—Alaska
California

Oregon, Western coastal region only
Washington, Western coastal region only

The division's boundaries were determined principally by geographic and geological features rather than by state boundary lines.

6. During 1975-80, within the State of Iowa, Shell's principal business consisted of marketing oil and chemical products refined and manufactured by the Products Organization. There were crude oil based Shell-manufactured products sold in Iowa which were manufactured from crude oil which was commingled to the extent that the ultimate source (OCS or non-OCS) of the crude oil could not be determined with any degree of certainty. All of Shell's activity in Iowa was of such a nature that

it fell within the purview of the Executive Vice President—Products. See paragraph 3, above.

7. Shell's activities as described in paragraph 2 of this Stipulation, including its activities on the OCS, constitute a unitary business, a portion of which, as stated in paragraph 6, was carried on within the state of Iowa during the years 1975 through 1980. Shell's activities are substantially similar to those described in the case of *Exxon Corp. v. Wisconsin Dept. of Revenue*, 447 U.S. 207 (1980).

II

OUTER CONTINENTAL SHELF OPERATIONS

AREA INVOLVED

8. Under the Outer Continental Shelf Lands Act (OCSLA), 43 U.S.C. § 1331, *et seq.*, the Outer Continental Shelf (OCS) is defined as "all submerged lands lying seaward and outside the area of lands beneath navigable waters as defined in section 1301 of this title, and of which the subsoil and seabed appertain to the United States and are subject to its jurisdiction and control." 43 U.S.C. 1331(a). Section 1301 of title 43 U.S.C. is part of the Submerged Lands Act (43 U.S.C. 1301 et seq.) and defines "land beneath navigable waters" as essentially that area within three miles of the coast line of the United States. (Texas owns 3 marine leagues into the Gulf of Mexico.) In short, the Outer Continental Shelf is the submerged land, as defined in 43 U.S.C. § 1331(a), which lies beyond the 3-mile limit. Rather than being a geographic feature, as would be inferred from its name, the OCS is a legal term describing the land extending seaward from a state's offshore boundary under water over which the United States claims economic or territorial jurisdiction. As such the OCS is not located in the State of Iowa or any other of the 50 states, so during 1975 through 1980 the actual extraction of OCS minerals did not occur in Iowa or any of the other 50 states. The

OCS surrounds the continental 48 states, Alaska and Hawaii.

9. The rights to explore for, develop and produce hydrocarbons (oil and gas) from beneath the OCS were conveyed by the federal government to private enterprises by way of lease sales. During the years at issue specific tracts of OCS land were selected to be the subjects of lease sales. The size of these tracts ranged from 750,000 to 1 million acres and the leases were usually in 5,000 or 5,760 acre blocks. The lease sale was advertised in the Federal Register at least 30 days before the sale with the sale date, place and time, the tracts to be offered, and the royalty amount (usually 1/6) set by the government.

Pursuant to the terms of the sale, sealed bids were submitted. Prospective bidders could bid alone or in conjunction with others. An amount equal to 20% of the bid price had to be submitted with the bid and all of the procedural requirements of the bidding procedure had to be observed. Leases went to the highest bidder, but a property might not be awarded to the highest bidder if the bid price was less than what the government considered a fair price for the area. If all bids were rejected on an area, that area was usually open for bidding in the next lease sale. On a successful bid it could take up to 30 days to announce whether the tract had been awarded, but the announcements usually followed within two weeks of the opening of bids. Thereafter, the winning bidder had 30 days to submit the 80% of the bid price not deposited with the bid along with the first years' rent.

The successful bidder received an oil and gas lease pursuant to the terms advertised in the announcement of the sale. Generally, the terms of the lease provided for a 1/6 royalty and gave the successful bidder the exclusive right to explore, develop, and produce petroleum from beneath the area awarded. The initial term (that time period during which actual extraction of gas or oil

must begin) was usually five years. There was generally a rental provision of $3 per acre per year. Rent was to be paid each year in advance during the initial five year period or until the start of production; after production started the rent would be paid in the form of a royalty based on production.

The term of the lease was to run for as long as there was production; absent production the lease would expire at the end of the five year initial term. The lease would of course terminate on abandonment or surrender by the leasee. Upon termination of the lease for any reason, the structures built thereon were to be removed and any wells to be plugged and abandoned in accordance with government regulations.

The leasing procedure for OCS leases is different from onshore leasing procedure. On land large lease areas can be acquired only where there are large individual or corporate landowners or where a number of smaller parcels of land can be assembled. In the face of competition for mineral properties it is extremely difficult to assemble a large block of small lease areas. On land the terms of the lease will vary depending on the bargaining positions of the parties, and allowable time prior to production usually will be shorter than that allowed for OCS leases.

Shell has onshore leases or owns land from which it extracts oil and gas and which is not part of the OCS.[1] Shell was and is constantly exploring for oil and gas in non-OCS areas.

EXPLORATION

10. The following description sets out Shell's activities pursuant to the OCS leasing procedures in effect during the years at issue. These leasing procedures pertain to Shell's leasing of mineral rights on government lands in the OCS from the Federal government. The Offshore Division's (Offshore) activities with respect to an offshore

lease usually commenced with a response to a government call for information regarding tracts set out in the Government's plan for leasing in a specific geographic area. The call for information usually occurred about two years before the tracts in question were to be the subject of a lease sale. The response to the call for information was an outline of a large general area of interest that Offshore would like to see come up for sale. Prior to the initiation of area-wide offshore sales in 1983, each prospective bidder would nominate individual tracts and only those tracts that received more than one nomination were put up for sale. In area-wide sales all the tracts in a defined area are put up for sale so a bidder does not have to wait until at least one other bidder also recognizes the hydrocarbon potential under a tract before it is put up for lease. In the years at issue (1975-80) the areas of interest were identified by actual lease block and by relative degree of desirability of the area; present practice is to describe the areas of interest by general geographic location.

11. Prior to the call for information, Offshore geophysicists would work up potential prospects using the existing seismic data relating to the general region of interest. The existing data may have contained seismic information generated in the course of Offshore's prior activities in the general area and information purchased from others engaged in commercial seismology. In addition, geophysicists would generate further seismic data in an attempt to locate geologic structures favorable to the accumulation of hydrocarbons. The additional seismic data was acquired by specially equipped ships towing an air gun which is used to "shoot" in the areas of interest. "Shooting" consists of systematically transmitting pulses of energy (analogous to sound waves) and receiving reflected or refracted waves from the rocks below the seabed. [This differs from onshore 'shooting' in that on land the pulses of energy may be transmitted directly to the

land with a device that delivers a shock to the earth's surface in the manner of a hammer, or dynamite may be used to generate the energy pulse.] Normally a one-mile grid of seismic data or profiles is obtained over the area of interest while sweeping a series of parallel lines, or lanes, in a shipborne seismic survey. The seismic profiles generated enable geologists and geophysicists, 1) to obtain a subsurface map of the geological structures, if any, underlying the area of activity, and 2) to project the distribution of sands (reservoir rock) from previous wells, if any, drilled nearby.

12. The foregoing activities were completed by approximately one year before the area of interest was planned to be the subject of a lease sale. About one year prior to the lease sale, when the sale areas were announced, the activity narrowed to the announced sale areas, and more geologic and seismic data was collected to narrow the search even further. By approximately six months prior to a planned lease sale the manpower and effort devoted to the study of specific areas or tracts increased and the number of areas which are the subject of the study decreased so that there was a greater concentration effort. The effort was principally in two areas, geologic and seismic. The geologic study dealt with defining the character of the reservoir rock; and the seismic study dealt with the determination of the characteristics of the reservoir and defining the overall reservoir structure and its complexities.

13. After the geologic and seismic data had been gathered, Offshore conducted review processes to determine which of the lease sale tracts was most promising for development and production. The potential net feet of hydrocarbons, productive area, type of hydrocarbons anticipated (oil, gas or both), recovery factors and probability of success went into calculating minimum, mean and maximum hydrocarbon volumes. These volumes along with economic considerations, such as wildcat costs

and development costs went into determining which leases would be bid on by Shell.

14. After a successful bid on a lease, the lease was put into Offshore's drilling schedule on a priority basis consistent with other demands on the available money and equipment. A primary term on a lease was usually five years; so at least one well was drilled in that period of time. Since there will have been no prior production from the lease area, the first well drilled was referred to as a "wildcat" well and was drilled for the purpose of determining if there was an economic quantity of hydrocarbons on the lease.

15. Wildcat wells are usually drilled from one of three types of equipment. If the well is to be drilled in 250 feet or less of water then what is referred to as a jack-up rig is used. That is, a watertight hull and platform with vertically adjustable legs is floated to the drill site; the legs are lowered until they rest on the seabed; and drilling operations are conducted from the platform. Most offshore wells are drilled with a jack-up type rig since most wells are drilled in less than 250 feet of water depth. The use of a jack-up rig could cost from $15,000 to $40,000 per day.

16. If the well is to be drilled in water between 250 feet and 3,000 feet deep then a semisubmersible rig is used for the drilling operations. A semisubmersible rig has a working deck similar to a jack-up rig, but it is stabilized by ballasting its pontoons and columns to a predetermined depth; anchor cables or thrusters keep the platform properly located for drilling. For wells drilled in water in excess of 3,000 feet, a drill ship is the normal mode of drilling. The use of a drill ship could cost about $250,000 per day. The actual cost of drilling a well depends on the depth to which the well is to be drilled and the cost of the rig used. Thus the cost of a wildcat well ranges from $1 million for a 6000 foot test to $15 mil-

lion for a 20,000 foot test in less than 250 feet of water. However, for a drill ship the costs could be ten times as high for equivalent depths below the sea floor.

17. If a wildcat well is successful there is often more seismic data gathered including velocity surveys. With the new data the reservoir structure is remapped. Although the seismic data acquired after the drilling of a successful wildcat well is gathered by the exploration department it is done after the well has been transferred from the exploration department to the production department both of which are in the Offshore Division of the E&P Organization. The gathering of seismic data is done by the exploration department because it has the necessary equipment and experience to do so.

PRODUCTION

18. After the potential rate of production and the potential recoverable reserves are determined, detailed engineering studies are conducted and plans are made toward the end of proposing a development program for the lease. If the program is adopted, Offshore enters into a contract to build a platform. The platform is fabricated and installed within a period of approximately six months if the property is in shallow water; a deep water project may take as long as two to three years. The average time to fabricate and install a platform is in a range of 12 to 18 months. A platform for the purpose for developing a lease may cost anywhere from $1.5 million for a platform to be used in ten feet of water to $12 million for a platform to be used in 285 feet of water and in the hundreds of millions of dollars for a platform to be used in 800 feet of water.

The OCS development procedures and costs are radically different from those practiced on land. For example, offshore operations may require that several wells that could be produced from be plugged and abandoned prior to finding the optimum placement for a platform from which the lease may be fully developed. On land

there is no physical constraint that the property be developed from a relatively small area such as a platform; so wells may be drilled on 40 acre, 160 acre, or 640 acre spacing. The cost of drilling is also dramatically different. On land one might expect to encounter costs as follows:

Depth of Well	Cost
5,000 ft.	$300,000-400,000
10,000 ft.	$750,000-1 million
15,000 ft.	$2 million

19. No production wells in the OCS are drilled prior to the installation of a platform; however, some of the exploration wells drilled in shallow water may be used for production as the property is developed. After the drill rig is installed on the platform the drilling operations begin. An 8 or 9 thousand foot well may take approximately 15 days to drill while a 17,000 foot well would take approximately 120 days. If the drilling is done in an oil field there will be production while other wells are being drilled. That is, after the first well is drilled production casing and the other equipment necessary for production will be installed, and production will start from that well. Thereafter a second well will be drilled and production equipment will be installed. Following the same pattern a third and fourth well will be drilled until the planned number of wells is completed. If the wells are being drilled in a gas field then for safety reasons all of the wells that are planned will be drilled and cased without production taking place during the drilling activity. Then the other necessary equipment is put in place to bring the wells into production.

20. The equipment necessary to the operation of a production well includes separators, water treatment facilities, test facilities, compressors, and metering equipment. Because the fluids recovered from a well are often

a complex mixture of oil, gas, and water, they must be separated into their components and treated to obtain a pipeline quality product. Several stages of separators may be used to separate the oil, gas, and the other components of the well fluid. The oil is treated sufficiently to obtain a quality acceptable to the pipeline operator servicing the platform. Similarly, the gas is treated until it is acceptable to the gas collection pipeline operator servicing the platform. Compressors are used to deliver the product to the pipeline at the proper pressure. The well fluids left after the separation of the gas and oil (mostly water) are run through water treatment facilities in the OCS until they meet the environmental standards required for their return to the sea.

The equipment necessary for the recovery of oil and gas offshore is substantially different from the equipment used onshore. The difference is such that down-hole and well-head equipment is not interchangeable between onshore and offshore applications. There are also substantial differences between surface (above-ground) and platform equipment. The safety features and the size and configuration requirements imposed by operation on an offshore platform make it so difficult to use onshore equipment on a platform that such an occurrence would be extremely rare; and the added expense of equipment designed for offshore platform use precludes its use for onshore operations.

21. Test facilities are maintained in the OCS to ensure the quality of the crude oil delivered to the pipeline operator. And, of course, metering facilities are necessary to determine how much product is delivered to the pipeline operator. The pipeline servicing the platform may be owned by Shell or owned by an independent third party. Once the crude oil is in the pipeline it is transported to shore (continental United States) for delivery to a refinery or other manufacturing facility of either Shell or an unrelated refiner or manufacturer. The refined and manufactured products are marketed throughout the world. Most, but not all, of the crude oil extracted by Shell from the OCS wells was brought from the OCS to the continental United States. This crude oil was either refined in Shell's refineries in the continental United States, or was exchanged by Shell with other oil companies. The portion of that crude oil which was refined was either sold or exchanged. These exchanges were with other companies in the Petro-Chemical industry.

As is done with respect to crude oil, test facilities are maintained on the OCS to ensure the quality of a natural gas delivered to the pipeline operator, and metering equipment is used to measure the amount of natural gas transferred. All of Shell's OCS natural gas production is sold to pipeline companies at the producing platform on the OCS.

25. . . .

Shell files tax returns with every state (45 states and the District of Columbia) that has an income tax or a franchise tax measured by income. With the exception of Mississippi, Oklahoma, Alaska (for 1978-81), Iowa (for 1977-80) and Florida, Shell apportioned its net income to all other states (without deduction of its separately-computed OCS net income, all as computed by Shell pursuant to the procedures in Exhibit 7) on the basis of a three-factor formula. Shell, in filing state income tax returns, has never excluded its total OCS value of production from the pre-apportionment net income base pursuant to the procedures in Exhibit 7. Shell's factors for use in the three-factor formula in the years at issue are set out in Exhibit 9, attached hereto. Had Shell deducted its separately-computed OCS net income in the just-stated computation, Shell would have paid less tax in each of those states in each of the years at issue with the exception of 1978. [In 1978 the effect of the

reduction of apportionable income by the amount of OCS net income would not have offset the increase in apportionable income caused by the increase in the apportionment formula percentage due to the removal of OCS property, payroll and sales from the apportionment factors.] Had Shell deducted its total OCS value of production it would have paid less tax in every year.

III

JURISDICTIONAL AND STATUTE OF LIMITATIONS FACTS

26. Shell keeps its books and records on the accrual method of accounting and its income is reported on a calendar year basis.

27. Shell timely filed Iowa Corporation Income Tax Returns, Forms IA 1120, for the years in issue as follows in accordance with extensions to file procured pursuant to Iowa Code sections 422.21 and 422.38:

Taxable Year	Date Filed
1975	October 28, 1976
1976	October 18, 1977
1977	October 25, 1978
1977 amended	March 12, 1980
1978	October 30, 1979
1979	October 23, 1980
1980	October 27, 1981

28. During the period March 8, 1982, through approximately March 12, 1982, the Iowa Department of Revenue ("Department"), by and through its auditors, conducted a field audit of Shell's corporate income tax returns relating to calendar years 1975-80 inclusive.

29. On or about April 19, 1982, Shell received an unsigned document designated Notice of Adjustment and Deficiency For Corporation Income Tax, Form No. 96-

051 (Notice of Adjustment). The Notice of Adjustment was dated April 15, 1982, and bore the account number 000007975003. The Notice of Adjustment reflected proposed additional tax amounts due or (refund due) as follows:

Taxable Year	Tax
1975	$ 143,345.90
1976	204,941.00
1977	43,129.46
1978	8,755.20
1979	(117,024.70)
1980	(40,110.50)
Total	$ 243,036.36

The above amounts are exclusive of interest.

30. Attached hereto as Exhibit 10 is a copy of the Notice Of Assessment For Corporation Income Tax, Form No. 96-052 (Notice of Assessment), dated June 10, 1982, which was received by Shell on or about June 14, 1982. The Notice of Assessment reflected additional Tax Amounts due for the periods 1975 through 1980 identical to those set out on the Notice of Adjustment referenced in paragraph (27) above.

31. On September 1, 1982, within the lawful 90 day period following the Department's issuance of the Notice of Assessment referenced in paragraph (28) above, Shell filed a written protest pursuant to Sections 422.28 and 422.41 of the Iowa Code setting forth its specific objections to the assessment.

32. The audit adjustments underlying the Department's assessment notification relate to the Department's interpretation of Iowa statutes, regulations and case law. None of the adjustments which are the subject of the assessment and this contested case proceeding are the

result of any adjustment made in any audit by the Internal Revenue Service for any taxable year.

33. Shell and the Department have not entered into any waiver agreement authorized by Iowa Code section 422.25(7).

34. The amount in controversy for each taxable year, to the parties' knowledge, does not fall within those items of gross income defined in the Internal Revenue Code of 1954, as amended, as will under that Code extend the statute of Limitations for Federal tax purposes to six years, as set forth in Iowa Code section 422.25(1). Accordingly, to the parties' knowledge Shell's returns for years 1975, 1976 and 1977 could not be examined by the Department on the basis of a six year Statute of Limitations in section 422.25(1) commencing from the time each such return was filed or became due, whichever time is later.

35. The amount in controversy for each taxable year is not, to the parties' knowledge derived from false or fraudulent returns made with the intent to evade tax.

36. The amount in controversy for each taxable year was not assessed because of either the carryback of net operating losses or of net capital losses. Shell had overpaid its estimated Iowa income taxes for 1979 and 1980.

37. Shell has not at any time relevant herein forwarded to the Iowa Department of Revenue a written notification concerning the final disposition of any matter or controversy existing between it and the Internal Revenue Service (IRS) with respect to any of the years in question, 1975-1977 inclusive. In addition, Shell has not sent to the Department a copy of any Federal document purporting to show the final disposition or final Federal adjustments for any of the years in question, 1975-1977 inclusive.

38. By execution of IRS Forms 872, the limitation of time for the assessment of any deficiency in Shell's reported liability for Federal income tax for the year 1975 was extended to March 31, 1980.

39. In March 27, 1980, Shell received a statutory notice of deficiency dated March 25, 1980, with respect to Shell's Federal income tax liability for 1975. This statutory notice of deficiency arose out of an audit by the IRS of Shell's 1975 Federal income tax return. The IRS made purported adjustments to Shell's Federal taxable income.

40. On August 11, 1980, Shell paid the liability stated on the March 25, 1980, Notice Of Deficiency.

41. On February 23, 1981, Shell filed a claim for refund of the amount paid on August 11, 1980. As of the date that this stipulation is filed no final decision has been made by the IRS regarding that claim for refund.

42. On December 28, 1981, the IRS sent Notices Of Deficiency to Shell setting out deficiencies in Shell's Federal income tax for the years 1976 and 1977. On or about March 26, 1982, Shell filed a petition in the United States Tax Court (Docket No. 6784-82) for a redetermination of the deficiencies set forth in those Notices Of Deficiency; the petition also claimed refunds for the years 1976 and 1977. As of even date no decision has been entered in that case. This statutory notice of deficiency arose out of an audit by the IRS of Shell's 1976 and 1977 Federal income tax returns. The IRS made purported adjustments to Shell's federal taxable income for years 1976 and 1977.

IV

THE ISSUES

43. Whether the Department of Revenue notice of assessment of June 10, 1982 (Exhibit 10), would result in the taxation of any revenues or any of the net income de-

rived by Shell from the OCS and, if so, whether that is in violation of the Outer Continental Shelf Lands Act (43 U.S.C. § 1331 *et. seq.*), and/or the Supremacy Clause of the United States Constitution (U.S. Const. Art. VI, cl. 2), and the case law applicable thereto.

44. Whether the Department of Revenue was required to make its assessment for the years 1975, 1976, and 1977 of additional tax against Shell reflected by the June 10, 1982, assessment (Exhibit 10) when the assessment was not based upon federal audit adjustments to federal taxable income within three years after Shell filed its Iowa Income Tax Returns for the years 1975, 1976 and 1977.

45. Whether, if Shell is entitled to exclude total OCS revenues from its pre-apportionment net income base as computed in Exhibit 7, pages 1-6, Shell is barred from claiming refunds for 1975-80 by reason of § 422.73 of the Iowa Code.

46. The parties agree that the issues, as stated above, shall take precedence over the framing of the issues by the Hearing Officer in his Notice of Time, Place. and Nature of Hearing, dated May 16, 1983. The parties further agree that Shell's protest shall be deemed amended to be consistent with the facts and issues stated herein.

47. Pursuant to the provisions of Iowa Code § 17A.12 and Department rule 730-7.14 IAC, a Notice of Time, Place and Nature of Hearing was sent by certified mail to Protestor and Protestor's authorized representative on May 16, 1983. Protestor and Protestor's authorized representative claimed that mailed notice from the Postal Service on May 17 and May 19, 1983.

48. Exhibits 1 through 6 are accounting schedules prepared by Protestor which attempt to separate out parts of Protestor's unitary business. Exhibits 1 through

6 apply only to the OCS. Protestor does not, for Federal income tax purposes, compute a federal taxable income solely for the OCS, nor is Protestor required to do so. The amount of "Total Revenue" on the unnumbered line after line 11 on Exhibits 1 through 6 is the same amount appearing as "OCS Value of Production" and is the amount Protestor claims should be excluded from Protestor's preapportionment net income for purposes of computing Protestor's Iowa income tax liability.

49. Exhibits 7 and 8 are Protestor's internal accounting breakdowns of income and taxation for Protestor.

50. Exhibit 9 is an internal accounting summary of sales, payroll and property broken down by years for each of Iowa, OCS and everywhere else.

51. Exhibit 11 is an affidavit signed by Mason J. Nevill and the following paragraphs 1 through 5 of that affidavit are as follows:

My name is Mason J. Nevill. I am employed by Shell Oil Company (Shell). As Manager, Domestic Raw Materials Supply, I have as part of my overall responsibility the responsibility for the Management of Shell Oil Company's Crude Oil Gathering Systems on the Outer Continental Shelf (OCS). I have held that position from 1973 until the present time.

I make this Affidavit in support of Shell's protest in the above-captioned matter. The information hereinafter recited is within my personal knowledge and has been acquired by me during the course and within the scope of my employment with Shell.

During the years 1975-80 Shell owned and operated crude oil gathering systems (pipelines) on the Outer Continental Shelf. Those systems were used to transport crude oil from production platforms owned by Shell and others on the OCS to common carrier pipelines which

completed the transportation of the crude oil from the OCS to onshore distribution or processing points.

All of the crude oil transported in Shell's gathering system was owned or controlled by Shell at the time it entered the gathering system. Shell purchased or received on exchange the non-Shell produced crude oil prior to its entry into the Shell gathering system.

During 1975-80 the fees charged for the transportation of crude oil in Shell's gathering system were calculated to derive maximum economic benefit to Shell. However, due to government controls, fluctuations in production and unpredictable mechanical difficulties with the gathering system the net income earned by the gathering system varied from year to year.

CONCLUSIONS OF LAW

1. The Department has jurisdiction of this matter under the provisions of Iowa Code §§ 422.28 and 422.41.

2. It is incumbent upon a taxpayer contesting a Department action to show that the action was erroneous. *R. K. Richards v. the Iowa Department of Revenue*, 360 N.W.2d 830 (Iowa 1985); *Dain Mfg. Co. of Iowa v. Iowa State Tax Commission*, 22 N.W.2d 786 (Iowa 1946) and *City of Ames v. State Tax Commission*, 71 N.W.2d 15 (Iowa 1955).

FIRST ISSUE

3. The first issue is set out in paragraph 43 of the *STIPULATION* of the parties and that issue reads as follows:

> 43. Whether the Department of Revenue notice of assessment dated June 10, 1982 (Exhibit 10), would result in the taxation of any revenues or any of the net income derived by Shell from the OCS and, if so, whether that is in violation of the Outer Continental Shelf Lands Act (43 USC section 1331 et seq.),

> and/or the Supremacy Clause of the United States Constitution (U.S. Const., Art. VI, Cl. 2), and the case law applicable thereto.

4. The first question in the first issue is whether the Notice of Assessment (Exhibit 10) would result in the taxation of any revenues or any of the income derived by Shell from the outer continental shelf.

5. (See Stipulation, paragraph 8). Under the Outer Continental Shelf Lands Act, the outer continental shelf (hereinafter referred to as the "OCS") is defined as "all submerged lands lying seaward and outside the area of the lands beneath navigable waters as defined in section 1301 of this title and of which the subsoil and seabed appertain to the United States and are subject to jurisdiction and control." That act further defines "land beneath navigable waters" as essentially that area within three miles of the coastline of the United States. The OCS is not located within Iowa or within any other of the fifty states.

6. At all times pertinent to this matter, Iowa Code subsection 422.33 (1) read, in pertinent part, as follows:

> . . . . .
>
> 1. If the trade or business of the corporation is carried on entirely within the state, the tax shall be imposed on the entire net income, but if such trade or business is carried on partly within and partly without the state, the tax shall be imposed only on the portion of the net income reasonably attributable to the trade or business within the state, said net income attributable to the state to be determined as follows:
> b. . . . . .
>
> Where income is derived from the manufacture or sale of tangible personal property, the part thereof attributable to business within the state shall be in

that proportion which the gross sales made within the state bear to the total gross sales.

. . . . .

7. Protestor's business constituted a unitary business for the years 1975 through 1980. Protestor's income is derived from the sale of tangible personal property. The Department's Notice of Assessment was based on the apportionment formula set out in Iowa Code § 422.33(1)(b) (See the preceding paragraph 6).

8. In *Exxon Corporation v. Wisconsin Department of Revenue*, 447 U.S. 207, 65L.Ed.2d 66, 100 S. Ct. 2109 (1980), at L.Ed. 2nd p. 80, the Supreme Court stated that the taxpayer had the distinct burden of showing that a state was taxing extraterritorial values and that a taxpayer's internal accounting system was not sufficient to prove the correct allocation between states. The reasoning and conclusions reached by the court in that case apply to this matter. Also, see *Butler Brothers v. McColgan*, 315 U.S. 501, 86 L.Ed. 991, 62 S. Ct. 701 (1942) and *Mobil Corp., infra*, paragraph 10. Protestor's evidence of OCS "net income" or "revenue" (except for some sales of gas on the OCS) consisted of allocations to the OCS made by protestor's internal accounting assignments and calculations. Those internal accounting conclusions are not sufficient proof of OCS "net income" or "revenue".

9. Since the burden of proof is on Protestor, Protestor would have to prove that the Department Notice of Assessment would result in the taxation of OCS revenues or net income. Protestor did not prove that the Department was actually taxing OCS income. Protestor did not prove the amount of its Iowa profits or lack of profits.

10. In *Mobil Oil Corp. v. Commissioner of Taxes*, 445 U.S. 425, 63L.Ed. 510, 100 S. St. 1223(1980), the Court was called upon to consider constitutional limitations on a nondomiciliary State's taxation of income received

from abroad by a corporation. At page 438 (445 U.S. 438) the Court stated:

> The argument that the source of the income precludes its taxability runs contrary to precedent. In the past, apportionability often has been challenged by the contention that income earned in one State may not be taxed in another if the source of the income may be ascertained by separate geographical accounting. The Court has rejected that contention so long as the intrastate and extrastate activities formed part of a single unitary business. See Butler Bros. v. McColgan, 315 US 501, 506-508, 86 sL Ed 991, 62 S Ct 701 (1942); Ford Motor Co. v. Beauchamp, 308 US 331, 336, 84 L Ed 304, 60 S Ct 273 (1939); cf. Moorman Mfg. Co. v. Bair, 437 US, at 272, 57 L Ed 2d 197, 98 S Ct 2340. In these circumstances, the Court has noted that separate accounting, while it purports to isolate portions of income received in various States, may fail to account for contributions to income resulting from functional integration, centralization of management, and economies of scale. Butler Bros. v. McColgan, 315 US at 508-509, 86 L Ed 991, 62 S Ct 701. Because these factors of profitability arise from the operation of the business as a whole, it becomes misleading to characterize the income of the business as having a single identifiable "source." Although separate geographical accounting may be useful for internal auditing, for purposes of state taxation it is not constitutionally required.
>
> The Court has applied the same rationale to businesses operating both here and abroad.

11. There is no recognized way that a unitary business can be accurately separated into separate enterprises for tax purposes. Any such separation would be, at best, an artificial, and not a real, separation. There

is no proof that the Notice of Assessment would result in the taxation of OCS "net income" or "revenues" and, therefore, there was no such taxation under the facts of this case.

12. The second question in the first issue (See paragraph 3 of these Conclusions of Law) is whether the use of the apportionment formula of Iowa Code Section 422.33(1)(b) is a violation of the OCSLA. Protestor's business is a unitary business and this question must be considered in the context of a unitary business and not as a theoretical question based on the theory that there is a theoretical "revenue" or theoretical "net income" "from the OCS."

13. In the case of *Continental Oil Company v. Federal Power Commission*, (1966) 370 F2d 57, 67, the court stated:

> "Congress passed the OCSLA solely to regulate the "leasing and development * * * of the oil potential of the Continental Shelf." H.R.Rep.No.413, 83d Cong., 1st Sess. 2-3 (1953), 2 U.S. Code Cong. & Ad.News p. 2178 (1953).

In the case of *Gulf Offshore Co. v. Mobil Oil Corp.*, 453 U.S. 473, 69 L.Ed.2d 784, 101 S. Ct. 2870 (1981), at pages (453 U.S.) 480, footnote 7, reads as follows:

"The legislative history confirms that the purpose of OCSLA was 'to assert the exclusive jurisdiction and control of the Federal Government of the United States over the seabed and subsoil of the Outer Continental Shelf, and to provide for the development of its vast mineral resources. . . ."

14. The Protestor cites 43 USCS 1333(a)(2)(A) as supporting its position on the first issue and that section reads as follows:

> "(2)(A) To the extent that they are applicable and not inconsistent with this Act or with other Federal laws and regulations of the Secretary now in effect or hereafter adopted, the civil and criminal laws of each adjacent State now in effect or hereafter adopted, amended, or repealed are hereby declared to be the law of the United States for that portion of the subsoil and seabed of the outer Continental Shelf, and artificial islands and fixed structures erected thereon, which would be within the area of the State if its boundaries were extended seaward and defining each such area. All of such applicable laws shall be administered and enforced by the appropriate officers and courts of the United States. State taxation laws shall not apply to the outer Continental Shelf."

15. 43 USCS 1353(a)(2)(A) uses the word "state" three times: First, as "adjacent State," then the second and third usages are simply "State." These usages are all concerning the application of an adjacent state's laws to the OCS, with the last sentence making that state's tax laws inapplicable to the OCS. All of those references to "State" concern the same subject—the application of the adjacent state's laws to the OCS. The Protestor has taken the last sentence of (a)(2)(A) out of context and is contending that the last sentence is a complete statement of general law by itself and should be read to mean that Protestor can carve out portions of a unitary business by internal accounting procedures and then the remainder can be apportioned under Iowa law. This hearing officer finds that all parts of 43 USCS 1333(a)(2)(A) should be construed together, that it all applies to adjacent States and not to Iowa.

16. The Protestor also cites 43 USCS 1333(a)(3) as supporting its position on the first issue. 43 USCS 1333(a)(3) reads as follows:

> "(3) The provisions of this section for adoption of State law as the law of the United States shall

> never be interpreted as a basis for claiming any interest in or jurisdiction on behalf of any State for any purpose over the seabed and subsoil of the outer Continental Shelf, or the property and natural resources thereof or the revenues therefrom."

As already determined, the adoption of State law in 43 USCS 1333(a)(2)(A), referred to in 43 USCS 1333(a)(3), refers to the adoption of an adjacent State's laws. The Department is not using *those sections* "as a basis for claiming any interest in . . . or the property and natural resources thereof or the revenues therefrom" under 43 USCS 1333(a)(3).

17. The hearing officer concludes that 43 USCS 1333(a)(2)(A) and 43USCS (a)(3) do not apply to the State of Iowa. The Protestor has failed to show that the intent of the OCSLA was to interfere with the unitary business body of law developed by the United States Supreme Court and other courts. The Protestor has failed to prove that the OCSLA prohibits the inclusion of Protestor's OCS business activities in the Iowa Code Section 422.33(1) apportionment formula.

18. A third question in the first issue is whether, under the Supremacy Clause of the United States Constitution, Iowa Code Section 422.33 is superseded by the Outer Continental Shelf Lands Act. Protestor seeks to have 43 USCS 1333(a)(2)(A) supersede Iowa Code Section 422.33. In *Subaqueous Exploration v. Unidentified, Wrecked Vessel*, U.S.D.C., District of Maryland (1983), 577 F.Supp. 597, 609, a case concerning the OCSLA, the court made this statement:

> "With respect to preemption and conflicts between state and federal laws, it is, of course, a fundamental principle of constitutional jurisprudence that the Supremacy Clause invalidates state laws that "interfere with, or are contrary to the laws of Congress . . ." Gibbons v. Ogden, 22 U.S. (9 Wheat.)1, 211,

> 63 L.Ed. 23 (1824). However, the "exercise of federal supremacy is not lightly to be presumed." New York Department of Social Services v. Dublino, 413 U.S. 405, 413, 93 S.Ct. 2507, 2513, 37 L.Ed.2d 688 (1973), quoting Schwartz v. Texas, 344 U.S. 199, 203, 73 S.Ct. 232, 235, 97 L.Ed. 231 (1952). "Preemption of state law by federal statute or regulation is not favored 'in the absence of persuasive reasons—either that the nature of the regulated subject matter permits no other conclusion, or that the Congress has unmistakably so ordained.'" Alessi v. Taybestos-Manhattan, Inc., 451 U.S. 504, 522, 101 S.Ct. 1895, 1905, 68 L.Ed.2d 402 (1981), quoting Chicago & North Western Transportation Co. v. Kalo Brick & Telephone Co., 450 U.S. 311, 317, 101 S.Ct. 1124, 1130, 67 L.Ed.2d 258 (1981)."

In this matter, Protestor has not proven that Congress has unmistakably ordained that Iowa Code Section 422.33 should be superseded by 43 USCS 1333(a)(2)(A) and has not proven that "the nature of the regulated subject matter permits no other conclusion." Iowa Code Section 422.33 is not superseded by the OCSLA under the Supremacy Clause of the U.S. Constitution.

19. Protestor cited the case of *Maryland v. Louisiana*, 451 US 725, 68L.Ed.2d 576, 101 S. Ct. 2114 (1981) in support of its contention that Iowa Code Section 422.33 violated the Supremacy Clause by including OCS business activities in its formula. In *Maryland*, the State of Louisiana had imposed a "first use" tax on natural gas brought into Louisiana, whenever that gas had not been subjected to a severance tax outside Louisiana. That "first use" tax, then, applied mostly to OCS gas. That tax statute was set aside by the United States Supreme Court because it discriminated against interstate commerce in favor of local businesses and because a section of that tax statute violated the Supremacy Clause. Loui-

siana is an "adjacent State" (See 43USCS 1333(a)(2)(A)). A section of the Louisiana statute violated the Supremacy Clause, as it was found to conflict with the Natural Gas Act, ISUSC717, et seq., which was enacted "to assure that consumers of natural gas receive a fair price and also to protect against the economic power of the interstate pipelines." (68L.Ed, at page 596). *Maryland* quoted the following two standards to judge whether a state law violates the Supremacy Clause:

> (1) "Of course, a state statute is void to the extent it conflicts with a federal statute—if, for example, 'compliance with both federal and state regulations is a physical impossibility,' Florida Lime & Avocado Growers, Inc. v. Paul, 373 US 132, 142-143, 10 L Ed 2d 248, 83 S Ct 1210 (1963) . . ." and (2) ". . . where the law 'stands as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress.'" Hines v. Davidowitz, supra, at 67, 85 L Ed 581, 62 S Ct 399. . . ."

In this matter, Iowa Code Section 422.33 does not make compliance with both that section and federal law an impossibility and it does not stand as an obstacle to the accomplishment of the full purposes and objectives of Congress. Iowa Code Section 422.33 is not superseded by the OCSLA, it does not conflict with the OCSLA and is not in violation of the Supremacy Clause of the United States Constitution.

SECOND ISSUE

20. The second issue is set out in paragraph 44 of the *STIPULATION* of the parties and that issue reads as follows:

> 44. Whether the Department of Revenue was required to make its assessment for the years 1975, 1976, and 1977 of additional tax against Shell reflected by the June 10, 1982, assessment (Exhibit

> 10) when the assessment was not based upon federal audit adjustments to federal taxable income within three years after Shell filed its Iowa Income Tax Returns for the years 1975, 1976 and 1977.

21. That issue asks the question whether the Department is restricted to making assessments solely based upon federal audit adjustments to federal taxable income after the 3 years period set out in Iowa Code Section 422.25(1) has ended. The Protestor had been audited by the IRS for the years in question and had never notified the Department in writing of the final disposition of the IRS matter, therefore the six months limitation period set out in Iowa Code 422.25(1) has never begun and has not expired.

22. This hearing officer considered that same issue (Second issue) in In The Matter Of Kelly-Springfield Tire Co., Docket No. 81-49-2A-A (A Department contested case, Proposed Order issued April 4, 1984, currently on appeal to the Iowa State Board of Tax Review). That Proposed Order discussed this same issue and the following paragraphs 23 through 36 are taken from that Order.

> 23. At the evidentiary hearing, the question of whether the six-month limitation clause of Iowa Code § 422.25(1) (1979) gave the Department the authority to make the assessment in this case was argued by both parties. That question was further refined so that the issue became whether or not an assessment authorized by the six-month limitation clause in Iowa Code § 422.25(1) (1979) was restricted to adjustments made by the IRS in its audit or if the Department could make an assessment on matters not covered by the IRS adjustments.
>
> 24. The limitation period set out in Iowa Code § 422.70 is five years. The assessment in this matter was in December, 1980. Neither party argued or

presented evidence to show that the assessment was authorized under Iowa Code § 422.70. The Hearing Officer concludes that the allegation that Iowa Code § 422.70 would authorize the assessment in this matter was abandoned by the parties.

25. The six-month period for assessment after final disposition of a controversy between a taxpayer and the IRS was added to Iowa Code § 422.25(1) by amendment in Chapter 211 Iowa Acts 1957, p. 269. That amendment added the following language to Iowa Code § 422.25 (1954):

> Notwithstanding the periods of limitation for examination and determination heretofore specified, the commission shall have six (6) months from the date of final disposition of any controversy between the taxpayer and the Internal Revenue Service with respect to the particular tax year to make its examination and determination.

The title to that Chapter 211 reads " AN ACT . . ., Relating to Periods of Limitation and Other Administrative Provisions . . ."

26. The six-month limitation period clause in Iowa Code § 422.25(1) was amended by Chapter 244, Iowa Acts 1973, p. 505, as follows:

> Notwithstanding the periods of limitation for examination and determination heretofore specified, the department shall have six months [from the date of final disposition of any controversy between the taxpayer and the internal revenue service with respect to the particular tax year to make the examination and determination.] *to make an examination and determination from the date of receipt by the department of notice from the taxpayer of the final*

> *disposition of any matter between the taxpayer and the internal revenue service with respect to the particular tax year. In order to begin the running of the six-months period, the notice shall be in writing in any form sufficient to inform the department of such final disposition with respect to such year, and a copy of the federal document showing the final disposition or final federal adjustments shall be attached to the notice.*

The title of Chapter 244 is "AN ACT relating to state income tax audits." The parties disagree as to the exact wording of the explanation in Senate File 76 (Chapter 244, Iowa Acts 1973). That explanation reads as follows:

> This bill allows the Department of Revenue six months from receipt of the final disposition of any controversy between the taxpayer and the Internal Revenue Service to notify the taxpayer of any additional tax due. Under the present law where no such notification ([by] *to*) taxpayer ([to] *by*) the Department of Revenue is required, thousands of dollars of Iowa state income taxes found to be due because of Internal Revenue Service audits are lost because of the limitation periods. This bill will prevent such loss of revenue without increasing any taxes, by merely clarifying a statute of limitation technicality to prevent loss of taxes otherwise clearly due the state.

The two words disagreed upon by the parties are enclosed in parentheses in the above quote. The Hearing Officer concludes that the two disputed words do not make any material difference in this matter.

27. The six-month limitation period clause in Iowa Code § 422.25(1) was again amended by Chapter

1140 Iowa Acts 1978, p. 688. That amendment added the underlined words so that the six-month limitation period clause read as follows:

> Notwithstanding the periods of limitation for examination and determination heretofore specified, the department shall have six months to make an examination and determination from the date of receipt by the department of *written* notice from the taxpayer of the final disposition of any matter *which occurred after the expiration of the applicable period of limitation specified in this section* between the taxpayer and the internal revenue service with respect to the particular tax year. In order to begin the running of the six-months' period, the notice shall be in writing in any form sufficient to inform the department of such final disposition with respect to such year, and a copy of the federal document showing the final disposition or final federal adjustments shall be attached to the notice.

28. The six-month limitation period clause in Iowa Code § 422.25(1) was again amended in 1981. The phrase "examination and determination" was not changed by the 1981 amendment.

29. Does the phrase "examination and determination" limit the Department to consideration of adjustments made by the IRS or does it authorize a wider inquiry into Protestor's tax liability? The six-month limitation period clause begins with this language: "Notwithstanding the periods of limitation for examination and determination heretofore specified, . . ." That "heretofore specified" examination and determination is set out in the first sentence of Iowa Code § 422.25(1), and that sentence, in pertinent part, reads as follows: "As soon as practicable and in any event within three years after the return is filed the department shall examine it and determine the correct amount of tax, . . ." That provision obviously is not restricted to adjustments by the IRS. The terms "examine" or "examination" and "determine" or "determin-ation," both appearing in Iowa Code subsection 422.24(1), would refer to the same acts or process and would have the same scope. Since the terms, when used in connection with the three year limitation, are not limited to IRS adjustments, it would follow, strictly from a reading of the Code, that the terms, when used in connection with the six-month limitation clause, were not limited to IRS adjustments.

30. In determining the meaning and scope of statutory language, the Iowa Supreme Court has adopted the following rules which are appropriate in this matter. In *Hinders v. City of Ames*, 329 N.W.2d 654, 655 (Iowa 1983), the Iowa Supreme Court quoted the following rules of statutory construction:

> [1] The purpose of all rules of statutory construction is to ascertain the intent of the enacting legislature. *See e.g., State v. Whetstine*, 315 N.W.2d 758, 760 (Iowa 1982); *American Home Products v. Iowa State Bd. of Tax*, 302 N.W.2d 140, 142 (Iowa 1981). Where, however, the language of the statute is clear and plain there is no room for construction, *see, e.g., Iowa National Industrial Loan Co. v. Iowa State Dep. of Revenue*, 244 N.W.2d 437,440 (Iowa 1974), and the sole function of this court is to apply the statute according to its terms. *See, e.g., State v. Sharkey*, 331 N.W.2d 68, 72 (Iowa 1981); *State v. Baker*, 293 N.W.2d 568, 572 (Iowa 1980).

31. The Iowa Supreme Court in *State v. Vietor*, 208 N.W.2d 894, 898 (Iowa 1973) stated as follows:

> [6] In construing statutes, the court searches for the legislative intent as shown by what the legislature has said rather than what it should or might have said. McKillip v. Zimmerman, Iowa, 191 N.W.2d 706, 709; Shriver v. City of Jefferson, Iowa, 190 N.W.2d 838, 839.

32. It is the conclusion of the Hearing Officer that, if the General Assembly had so intended, it could have limited the examination to adjustments made by the IRS, but chose to use the same words ("examine" and "determine") in connection with both the three year and six month limitation clauses in Iowa Code § 422.25(1). This statutory wording is plain, unambiguous and consistent throughout Iowa Code § 422.25(1).

33. Judge Anthony M. Critelli, in the Polk County, Iowa District Court case of *Moorman Manufacturing Company v. G. D. Bair, Director of Revenue, State of Iowa*, in Equity No. CE3-15——, in an opinion issued December 17, 1976, found that:

> The duty of the department, to be accomplished "as soon as practicable and in any event within three years" from the filing of a corporate taxpayer's returns, is to "examine" the returns and "determine" the correct amount of tax. Section 422.25. Notwithstanding this general limitation, the department is given an addition six months which begins upon the resolution of a controversy existing between the taxpayer and Internal Revenue Service to "examine and determine" the taxpayer's Iowa returns in light of the final disposition made between the taxpayer and Internal Revenue Service. During either the first three year period or a second six months extension, the scope of the department's inquiry respecting the taxpayer's returns is the

> same—the department must "examine" and "determine."
>
> Webster's Seventh New Collegiate Dictionary 288-9 (1965) defines the verb "examine" to mean "to inspect closely; to test the condition of; to inquire into carefully . . . ." "Determine," as a verb, is defined to include the following actions: "to fix conclusively or authoritatively; to decide by judicial sentence; to settle or decide by choice of alternatives or possibilities; . . . to come to a decision . . . ." *Id.*, at 226.
>
> Because the legislature gave the department the same latitude in reviewing a taxpayer's returns after a federal audit had begun as the department had initially within the original three year examination period, the conclusion would seem inescapable that the department is not limited to a mere *recomputation* of the taxpayer's Iowa liability based upon newly developed federal figures (emphasis added). The department is accorded the authority, as they are in the first instance, to scrutinize and inspect the Iowa returns and decide and fix the amount of tax liability. Thus it is apparent that the department may challenge Moorman's apportionment formula and the tax liability following from its use in the period beyond the three year limitation as within its powers to both "examine and determine."
>
> More supportive still of this conclusion is a focus on another aspect of the six months statutory exception. Regarding the nature of the controversy existing between the taxpayer and Internal Revenue Service, Section 422.25 says ". . . the department shall have six months

from the date of final disposition of *any* controversy between the taxpayer and the internal revenue service. . . ." (emphasis added).

We cannot help but believe that the broad powers vested in the department to "examine and determine" anew after a federal audit had begun were powers then constrained to such duties only if the federal audit produced adjusted income which, in turn, might adjust Iowa taxable income. It is plain that the controversies between the taxpayer and Internal Revenue Service which can result in application of the department's statutory duties are not just certain controversies whose resolution changes the taxpayer's base for Iowa tax purposes but "any controversy" whether a change affecting Iowa tax results or does not result.

In *Moorman*, the federal audit made no difference in taxpayer's Iowa tax liability; the assessment was based on items not adjusted by the federal audit. The foregoing decision was appealed on other issues, but not on the issue discussed in this paragraph.

34. In the case of *American Home Products Corporation*, Docket No. 192, the Iowa State Board of Tax Review held that the Department could make an assessment under the six months clause of Iowa Code § 422.25(1) on items not adjusted by the federal audit. That decision was issued on June 2, 1979. The Board's decision on the foregoing issue was appealed to the Polk County District Court, Docket No. CE11-6178, and, in a decision filed February 20, 1980, Judge J. P. Denato upheld the Board's decision. The judge's decision on that issue was not appealed, though other issues were appealed.

35. Protestor cited cases from other states in support of its proposed interpretation of Iowa Code § 422.-

25(1). The Hearing Officer concludes that these cases are not persuasive because of the plain language of Iowa Code § 422.25(1) and because the cases from other states are based on different, though similar, statutes.

36. As previously discussed, it is the conclusion of the Hearing Officer that the plain language of Iowa Code § 422.25(1) grants the Department the authority to make the assessment in this case; that the State Board of Tax Review has upheld the Department's authority to make such an assessment; and that the Polk County District Court has upheld the Department's authority to make such assessments in two decisions.

37. The hearing officer concludes that the Department is not restricted to assessments based on federal audit adjustments based on the reasoning and citations in Kelly-Springfield, supra, paragraphs 22 through 36.

THIRD ISSUE

38. The third issue is set out in paragraph 45 of the *STIPULATION* of the parties and that issue reads as follows:

> 45. Whether, if Shell is entitled to exclude total OCS revenues from its pre-apportionment net income base as computed in Exhibit 7, pages 1-6, Shell is barred from claiming refunds for 1975-80 by reason of § 422.73 of the Iowa Code.

39. For the years 1975 through 1978, the following Iowa Code Section 422.73 was in effect:

> 422.73. Correction of errors. If it shall appear that, as a result of mistake, an amount of tax, penalty, or interest has been paid which was not due under the provisions of this chapter, then such amount shall be credited against any tax due, or to

become due, under this chapter from the person who made the erroneous payment, or such amount shall be refunded to such person by the department. No claim for refund or credit that has not been filed with the department within five years after the tax payment upon which a refund or after such tax payment was made, whichever time is the later, shall be allowed by the director. Notwithstanding the period of limitation specified, the taxpayer shall have six months from the day of final disposition of any income tax controversy between the taxpayer and the internal revenue service with respect to the particular tax year or years to claim an income tax refund or credit, provided the taxpayer has notified the department of revenue of the existence of said income tax controversy within the five-year limitation period.

40. For the years 1979 and 1980, the following Iowa Code Section 422.73, as amended by 1978 Iowa Acts Chapter 1140, applied to corporate income tax and that section read, in pertinent part, as follows:

> 2. If it shall appear that, as a result of mistake, an amount of tax, penalty, or interest has been paid which was not due under the provisions of divisions II, III or V of this chapter, then such amount shall be credited against any tax due, or to become due, under this chapter from the person who made the erroneous payment, or such amount shall be refunded to such person by the department. A claim for refund or credit that has not been filed with the department within three years after the return upon which a refund or credit claimed became due, or within one year after the payment of the tax upon which a refund or credit is claimed was made, whichever time is the later, shall not be allowed by the director; . . .
>
> . . . Notwithstanding the period of limitation specified, the taxpayer shall have six months from the day of final disposition of any income tax matter between

> the taxpayer and the internal revenue service with respect to the particular tax year or years to claim an income tax refund or credit, provided the taxpayer has notified the department of revenue in writing no later than six months after the expiration of the three-year limitations period of the existence of such income tax matter.

41. For the years 1975 through 1978, Iowa Code Section 422.73 states that the Director "shall" not grant a refund unless the claim is timely filed (within 5 years). For 1979 and 1980, the Director "shall" not grant a refund unless the claim is timely filed (within 3 years). No refund claim was filed by Protestor for the years 1975 through 1980.

42. Protestor contends that Iowa Code Section 422.73 does not preclude the granting of a refund in cases where the Department commenced an audit and determined that taxpayer had overpaid the tax. Protestor cites Iowa Code Section 422.25(1), Iowa Code Section 422.28 and a State Board of Tax Review opinion in the case of *Iowa Manufacturing Company of Cedar Rapids v. Iowa Department of Revenue* (opinion dated July 31, 1968) in support of that contention.

43. Iowa code Subsection 422.25(3) provides that "If the amount of the tax as determined by the department" is less than the amount paid, the excess shall be refunded. That provision applies to Department audits. In this matter, the Department did not "determine", by audit, that Protestor had overpaid tax because of OCS revenues. On this third issue, Protestor is attempting to obtain a refund on grounds not previously considered by either audit or refund claim. Iowa Code Section 422.25(3) does not require or authorize the granting of such a refund.

44. Iowa Code Section 422.28 reads, in pertinent part, as follows:

"A taxpayer may appeal to the director for revision of the tax, interest or penalties assessed at any time within ninety days from the date of the notice of the assessment of tax, additional tax, interest or penalties. The director shall grant a hearing and if, upon the hearing, the director determines that the tax, interest or penalties are excessive or incorrect, the director shall revise them according to the law and the facts and adjust the computation of the tax, interest or penalties accordingly. The director shall notify the taxpayer by registered mail of the result of the hearing and shall refund to the taxpayer the amount, if any, paid in excess of the tax, interest or penalties found by the director to be due, with interest after sixty days from the date of payment by the taxpayer at the rate in effect under section 421.7 for each month or a fraction of a month. . . ."

45. Iowa Code Section 422.28 provides for an appeal "for revision of the tax, interest or penalties assessed. . . ." What was "assessed"? That section goes on to state that the appeal must be within 90 days from "the date of the notice of the assessment of tax, additional tax, interest or penalties." The tax, interest and penalty "assessed" is the assessment set out on the notice of assessment. The subject of the appeal and the hearing would be the assessments appearing on the notice of assessment and not refund claims, first presented in the protest, based on facts, items or theory different from the basis for the assessment of taxes, interest or penalty assessed in the Notice of Assessment. Protestor cannot present a refund claim in its protest based on grounds or items which were not the basis for the assessment.

46. In *Iowa Manufacturing Company*, supra, the Department discovered the overpayment of taxes on audit, but disagreed on the granting of the refund because of Iowa Code Section 422.66 (now 422.73). In this case,

Protestor seeks to present a totally unrelated refund claim, not timely presented as a refund claim under Iowa Code Section 422.73(2), during an appeal for revision of the assessment set out on the notice of assessment. Because of the factual difference, *Iowa Manufacturing*, supra, does not apply. Protestor cannot obtain a refund in this matter on the basis of the third issue facts or law.

SUMMARY

47. The issues in this matter were stipulated by the parties (See paragraphs 43, 44 and 45 of the Stipulation and Findings of Fact). Other issues and peripheral issues argued in the Briefs were not properly or timely raised and are not considered in this Proposed Order. This Proposed Order is confined strictly to the issues set out in the Stipulation.

48. As stated in preceding paragraphs 19, 37 and 46 of these Conclusions of Law, the Protestor has failed to prove that the assessment was in error. The Department properly and legally assessed the tax, interest and fees for corporation income tax as the assessment is set out on a Notice of Assessment bearing notice date of June 10, 1982. It is the conclusion of the hearing officer, based on the whole record, that the evidence in this matter is more than substantial to support the factual and legal conclusions reached by the hearing officer in this Proposed Order.

49. An Order For Deletion was entered in this matter on December 14, 1984, deleting exhibits 1 through 10 and exhibits G through L from the protest file prior to disclosure to members of the public.

50. A First Supplement To Deletion Order was issued by the hearing officer on July 23, 1985. That deletion order was restricted to deletions from documents in existence at the time of the order, with the deletions specifi-

cally set out on copies of the documents from which deletions were made. These deletions are as follows:

BRIEF OF PROTESTOR

Page 3—amounts deleted from chart

Page 8—second paragraph

Page 9—second sentence

Page 12—second paragraph, second and fourth sentence

Page 14—amounts deleted from chart

Page 17—amounts deleted from chart

Page 49—second paragraph of (b)

Page 50—first paragraph amounts deleted from chart

Page 63—amounts deleted from chart

Page 64—amounts deleted from chart

REPLY BRIEF OF PROTESTOR

Page 10—amounts deleted from chart

Page 15—amounts deleted from chart

Page 21—paragraph 1 of V

Page 22—first paragraph, fourth sentence

Page 23—end of first full paragraph

Page 24—paragraph (c)

Page 25—first paragraph, first sentence

Page 26—first sentence

BRIEF OF DEPARTMENT OF REVENUE

Page 6—third paragraph, first sentence

Page 14—second paragraph

Page 15—footnote 2

Page 19—second, third, fourth sentences
Footnote 4

Page 20—last two sentences on page

Page 32—first paragraph, fifth sentence

Page 35—first sentence

51. Pursuant to Iowa Code § 17A.15(3), this Proposed Order becomes the final order of the Iowa Department of Revenue without further proceedings unless there is an appeal to, or review on motion of, the Department within 30 days of the issuance of this Proposed Order.

Issued at Des Moines, Iowa, this 26th day of August, 1985.

IOWA DEPARTMENT OF REVENUE

By Orville Caruthers
Orville Caruthers
Hearing Officer

APPENDIX E

IN THE SUPREME COURT OF IOWA

Supreme Court No. 86-1565

SHELL OIL COMPANY,
Petitioner-Appellant,

vs.

THE IOWA DEPARTMENT OF REVENUE,
Respondent-Appellee.

[Filed Nov. 23, 1987]

NOTICE OF APPEAL TO THE UNITED STATES SUPREME COURT

NOTICE IS HEREBY GIVEN that Shell Oil Company appeals to the United States Supreme Court, pursuant to 28 U.S.C. § 1257(2), from the judgment of the Iowa Supreme Court set forth in Part II, beginning on page 10, of the opinion of this Court in these proceedings, filed October 21, 1987, entitled "Claims Involving Taxation of Revenues Derived From Outer Continental Shelf Lands", and all rulings and judgments inherent therein.

Dated this 19th day of November, 1987.

/s/ James W. Hall
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APPENDIX F

STATUTORY PROVISIONS INVOLVED

Section 4(a) of the Outer Continental Shelf Lands Act, 43 U.S.C. § 1333(a), provides (emphasis added):

> (1) The Constitution and laws and civil and political jurisdiction of the United States are extended to the subsoil and seabed of the outer Continental Shelf and to all artificial islands, and all installations and other devices permanently or temporarily attached to the seabed, which may be erected thereon for the purpose of exp[l]oring for, developing, or producing resources therefrom, or any such installation or other device (other than a ship or vessel) for the purpose of transporting such resources, to the same extent as if the outer Continental Shelf were *an area of exclusive Federal jurisdiction* located within a State: *Provided, however,* That mineral leases on the outer Continental Shelf shall be maintained or issued only under the provisions of this subchapter.
>
> (2)(A) To the extent that they are applicable and not inconsistent with this subchapter or with other Federal laws and regulations of the Secretary now in effect or hereafter adopted, the civil and criminal laws of each adjacent State, now in effect or hereafter adopted, amended, or repealed are declared to be the law of the United States for that portion of the subsoil and seabed of the outer Continental Shelf, and artificial islands and fixed structures erected thereon, which would be within the area of the State if its boundaries were extended seaward to the outer margin of the outer Continental Shelf, and the President shall determine and publish in the Federal Register such projected lines extending seaward and defining each such area. All of such applicable laws shall be administered and enforced by the appropriate officers and courts of the United States. *State taxation laws shall not apply to the outer Continental Shelf.*

> (B) Within one year after September 18, 1978, the President shall establish procedures for sett[l]ing any outstanding international boundary dispute respecting the outer Continental Shelf.
>
> (3) The provisions of this section for adoption of State law as the law of the United States *shall never be interpreted as a basis for claiming any interest in* or jurisdiction on behalf of any State for any purpose over the seabed and subsoil of the outer Continental Shelf, or *the property and natural resources thereof or the revenues therefrom.*

23 Iowa Code Ann. §§ 422.32, 422.33, 422.35 provide in pertinent part:

§ 422.32. Definitions

For the purpose of this division and unless otherwise required by the context:

* * * *

5. The term "unitary business" means a business carried on partly within and partly without a state where the portion of the business carried on within the state depends on or contributes to the business outside the state.

* * * *

10. "State" means any state of the United States, the District of Columbia, the Commonwealth of Puerto Rico, any territory or possession of the United States, and any foreign country or political subdivision thereof.

§ 422.33. Corporate tax imposed—credit

* * * *

2. If the trade or business of the corporation is carried on entirely within the state, the tax shall be im-

posed on the entire net income, but if the trade or business is carried on partly within and partly without the state, the tax shall be imposed only on the portion of the net income reasonably attributable to the trade or business within the state, with the net income attributable to the state to be determined as follows:

* * * *

(4) Where income is derived from the manufacture or sale of tangible personal property, the part attributable to business within the state shall be in that proportion which the gross sales made within the state bear to the total gross sales.

§ 422.35. Net income of corporation—how computed

The term "net income" means the taxable income before the net operating loss deduction, as properly computed for federal income tax purposes under the Internal Revenue Code of 1954, with the following adjustments * * *.

APPENDIX G

STATEMENT PURSUANT TO RULE 28.1

SHELL OIL COMPANY *

A. *Shell Oil Company*

Subsidiary Companies

IND/AG Chemicals, Inc.
Pecten Arabian Company
Pecten Cameroon LNG Limited
Pecten Chemicals Inc.
Pecten Export Corporation
Pecten Middle East Services Company
Pecten Trading Company
Pecten Ventures Limited
Pecten Vietnam Company
SES, Incorporated
Shell Agricultural Chemical Company
Shell Capital, Inc.
Shell Communications, Inc.
Scallop Corporation
Shell Credit, Inc.
Shell Energy Resources Inc.

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* Shell Oil Company's parent corporation is SPNV Holdings, Inc., which, in turn, is owned by Shell Petroleum N.V. The latter's parents are Royal Dutch Petroleum Company (a Netherlands corporation) and The "Shell" Transport and Trading Company, p.l.c. (a United Kingdom corporation). Shell Oil Company itself owns directly or indirectly, both 100% and less than 100% stock interests in approximately 120 corporations that operate both in the United States and in foreign countries. All of the companies are often referred to collectively as the "Royal Dutch/Shell Group of Companies." Counsel is advised that there are subsidiaries, not wholly owned, and affiliates throughout the world of this group which, in the aggregate, are so numerous that they could not be determined or identified for the Court within the time frame for filing this Jurisdictional Statement.

Shell Export Company
Shell Investment, Inc.
Shell Motorist Club, Inc.
Shell Pipe Line Corporation
Shell Polymers and Catalysts Enterprises Inc.
Triton Biosciences Inc.
Western Farm Services, Inc.

Affiliated Companies

Fractionation Research, Inc.
Gravcap, Inc.
Heat Transfer Research, Inc.
Inland Corporation
Loop, Inc.
Lucky Chance Mining Company, Inc.
Mesbic Financial Corporation of Houston
Oil Companies Institute for Marine Pollution Compensation Limited
Oil Insurance Limited
Seadock, Inc.

B. *Shell Credit, Inc.*

Subsidiary Companies

Shell Finance Company
Shell Leasing Company

C. *Shell Energy Resources Inc.*

Subsidiary Companies

Pecten International Company
Shell Gas Pipeline Company
Shell Gas Trading Company
Shell Mining Company
Shell Offshore Inc.
Shell Western E&P Inc.
Scallop Coal Company

D. *Pecten International Company*

Subsidiary Companies

Pecten Argentina Company
Pecten Ash Sham Company
Pecten Bahamas Company
Pecten Belize Company
Pecten Brazil Alagoas Company
Pecten Brazil Alagoas Petroleum Company
Pecten Brazil Amazon Company
Pecten Brazil Amazon Exploration Company
Pecten Brazil Amazon Exploration and Development Company
Pecten Brazil Amazon Petroleum Company
Pecten Brazil Bahia Company
Pecten Brazil Bahia Exploration Company
Pecten Brazil Bahia Exploration and Development Company
Pecten Brazil Bahia Petroleum Company
Pecten Brazil Exploration Company
Pecten Brazil Maranhao Company
Pecten Brazil Maranhao Exploration Company
Pecten Brazil Petroleum Company
Pecten Brazil Rio Grande Do Norte Company
Pecten Cameroon Company
Pecten Canada Limited
Pecten Ecuador Company
Pecten Guinea-Bissau Company
Pecten Malaysia Company
Pecten Malaysia Petroleum Company
Pecten Orient Company
Pecten Overseas Petroleum Company
Pecten Paraguay Company
Pecten Portugal Company S.A.R.L.
Pecten Potiguar Company
Pecten Santos Company
Pecten Santos Exploration Company
Pecten Santos Petroleum Company

Pecten Sarawak Company
Pecten Syria Company
Pecten Syria Petroleum Company
Pecten Tanzania Company
Pecten Tunisia Company
Pecten Victoria Company
Taranaki Offshore Petroleum Company

E. *Shell Mining Company*

Subsidiary Companies

Bellaire Trucking Company
Pecten Coal International Inc.
R. & F. Coal Company
Triton Coal Company
Turris Coal Company
Billiton Metals Inc.
Billiton Minerals U.S.A. Inc.

F. *Shell Offshore Inc.*

Subsidiary Companies

Burrwood Gathering Company
SOI Royalties Inc.

G. *Shell Western E&P Inc.*

Subsidiary Companies

Belridge Farms
Belridge Packing Co.
Chaparro Gathering Company
Choctaw Pipe Line Company
Swepi Royalties Inc.
Shell California Offshore Pipeline Inc.
Shell Cortez Pipeline Company
Shell Western Pipelines Inc.
East Texas Salt Water Disposal Company

Grande Ecallie Land Company, Inc.
Thums Long Beach Company
Van Salt Water Disposal Company
WIDC (Wyoming Industrial Development Corporation)

H. *Shell Cortez Pipeline Company*

Affiliated Company

Cortez Capital Corporation

I. *Pecten Arabian Company*

Subsidiary Company

Pico Limited

J. *Taranaki Offshore Petroleum Company*

Subsidiary Company

Taranaki Offshore Petroleum Company Limited

K. *Shell Chemical Company*
(a division of Shell Oil Company)

Affiliated Companies

George Newman & Company
United Scientific, Inc.

L. *Pecten Trading Company*

Affiliated Company

Oil Companies Institute for Marine Pollution Compensation Limited

M. *Western Farm Service, Inc.*

Subsidiary Company

Pioneer Equipment Co.

N. *Shell Pipe Line Corporation*

Subsidiary Companies

Butte Pipe Line Company
San Joaquin Valley Pipe Line Company

Affiliated Companies

Dixie Pipeline Company
Explorer Pipeline Company
Locap, Inc.
Olympic Pipe Line Company
Plantation Pipe Line Company
West Shore Pipe Line Company
Wolverine Pipe Line Company

O. *Shell Polymers and Catalysts Enterprises Inc.*

Subsidiary Companies

Ardyne Inc.
CRI Ventures, Inc.
Morrison Molded Fiber Glass Company
Premix/EMS Inc.
Quazite Corporation
Rampart Packaging Inc.
Xerkon Inc.

P. *Morrison Molded Fiber Glass Company*

Subsidiary Companies

AFC, Inc.
Glastrusions, Inc.
Glass-Steel, Inc.

Q. *Scallop Coal Company*

Subsidiary Companies

Justin Coal Corporation
Marrowbone Development Company
Wolf Creek Collieries Company
Massey Coal Terminal Corporation

R. *Billiton Metals Inc.*

Subsidiary Companies

Billiton Commodies Inc.

S. *Scallop Corporation*

Subsidiary Companies

AP Shipping Corporation
Argus Realty Services Inc.
Asiatic Petroleum Corporation
Greater New York Terminal, Inc.
Houston Fuel Oil Terminal, Inc.
Nickerson American Plant Breeders Inc.
Royal Lubricants Company, Inc.
Scallop Liquified Natural Gas, Inc.

T. *Marrowbone Development Company*

Subsidiary Companies

Big Beaver Coal Company

U. *Massey Coal Terminal Corporation*

Subsidiary Companies

Clipper Coal Corporation
Comcoal Corporation
East Kentucky Energy Corporation
Kermit Coal Company
Pike County Coal Corporation
Redbone Coal Company, Inc.
Massey Coal Terminal S. C. Corporation
SLT Corporation
Sunset Coal Corporation
Tug River Mining Group, Inc.

V. *Massey Coal Terminal S. C. Corporation*

Subsidiary Companies

Cooper River Coal Terminal Company

Supreme Court, U.S.
FILED
JAN 8 1988
JOSEPH F. SPANIOL, JR.
CLERK

No. 87-984

In The
Supreme Court of the United States
October Term, 1987

SHELL OIL COMPANY,
Appellant,
v.
THE IOWA DEPARTMENT OF REVENUE,
Appellee.

On Appeal from the Supreme Court of Iowa

MOTION OF APPELLEE TO DISMISS OR AFFIRM

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QUESTION PRESENTED

Whether the State of Iowa is prohibited by the Outer Continental Shelf Lands Act, 43 U.S.C. § 1333(a), from imposing a tax upon its apportioned share of a unitary net income base, in the absence of evidence that the apportioned share exceeds net income derived from the taxpayer's income producing activities in Iowa.

PARTIES TO PROCEEDINGS BELOW

The parties before the Supreme Court of Iowa with respect to the question presented were Shell Oil Company and the Iowa Department of Revenue.

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United States v. Texas, 339 U.S. 707 (1950) 16

STATUTES:

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43 U.S.C. § 1333(a) 1, 17

Iowa Code § 422.35 3

MOTION TO DISMISS OR AFFIRM

In accordance with Sup. Ct. R. 16, the Appellee, Iowa Department of Revenue, moves to dismiss the appeal of Shell Oil Company (Shell) on the grounds that the appeal does not present a substantial federal question or to affirm the decision of the Supreme Court of Iowa for the reason that 43 U.S.C. § 1333(a) does not implicate a state unitary business/formula apportionment method not shown to result in an income attribution to the taxing state in excess of net income derived from the taxpayer's income producing activities in that state.

—o—

STATEMENT OF THE CASE

In the years 1975 through 1980, Shell's principal business activities were the exploration for, and development, production, transportation, purchase, and marketing of crude oil and natural gas, and the purchase, manufacture, and marketing of oil and chemical products. (J.S. App. 16a; Stip. par. 2).[1] Shell has stipulated that its operations, within and without the outercontinental shelf (OCS), including its Iowa activities, constitute a single unitary business similar to those in *Exxon Corp. v. Wisconsin Department of Revenue*, 447 U.S. 207 (1980). (J.S. App. 18a; Stip. par. 7).

Shell's Exploration and Production Organization Division transferred most, but not all, of Shell's OCS crude

[1]References to the "Appendices" attached to Shell's Jurisdictional Statement will be to "J.S. App." References to Shell's Jurisdictional Statement text will be "J.S."

oil to the continental United States. (J.S. App. 17a, 20a; Stip. pars. 4, 21). This crude oil was either exchanged with other oil companies or was first refined by Shell and then sold or exchanged. (J.S. App. 20a; Stip. par. 21). If the crude oil was refined by Shell, it was commingled with crude oil from other sources so that the ultimate source of the oil (OCS or non-OCS) is indeterminable. (J.S. App. 17a-18a; Stip. par. 6).

The intracompany transfers of Shell's extracted crude oil were to Shell's Products Organization Division. (J.S. App. 17a; Stip. par. 4). These transfers were recorded by Shell as "sales", but no money was ever paid. (J.S. App. 17a; Stip. par. 4). These recorded transfers occurred with respect to crude oil production in OCS and in non-OCS areas. (J.S. App. 17a; Stip. par. 4). Shell was a "net purchaser" of crude oil, that is, Shell's total crude oil production was insufficient to satisfy Shell's crude oil requirements, so that Shell purchased the balance of its crude oil needs from other sources, including OCS producers, domestic producers, and foreign source producers. (J.S. App. 17a; Stip. par. 4).

Shell also produced natural gas in the OCS. In contrast to crude oil, Shell sold all of its OCS natural gas at the OCS wellhead to natural gas transmission companies for cash. (J.S. App. 7a-8a).

Shell's unitary Iowa business activities involved the sale of oil and chemical products which Shell had refined and manufactured outside of Iowa. (J.S. App. 17a; Stip. par. 6). Shell sold crude oil based products in Iowa which it had manufactured from commingled OCS and non-OCS oil. (J.S. App. 17a-18a; Stip. par. 6).

Iowa imposes an income tax upon corporations doing business in Iowa. The unitary net income of a corporation is determined with respect to taxabale income computed for federal income tax purposes.[2] (J.S. App. 96a). The unitary net income of a corporation, such as Shell, which does business within and without Iowa is apportioned by application of a single sales factor formula in order to obtain a reasonable estimate of Iowa net income. This method of apportionment was upheld, against constitutional attack upon Due Process and Commerce Clause grounds, in *Moorman Manufacturing Company v. Bair*, 437 U.S. 267 (1978).[3] Shell concedes that the Iowa sales formula apportionment method properly attributes its income to Iowa and that Shell could not challenge the Iowa formula on Due Process or Commerce Clause grounds. (J.S. 7, 12).

The Iowa Department of Revenue audited Shell's Iowa income tax returns and assessed additional Iowa tax to Shell.[4] Shell protested the assessment and claimed that it

---

[2]Iowa Code § 422.35 does contain some adjustments to the federal taxable income figure, but these adjustments are not relevant to this case.

[3]The Iowa Supreme Court has interpreted the Iowa unitary business/formula apportionment method for determining Iowa taxable income as one which "manifests an intent on the part of the legislature to impose a tax on all foreign corporate activities in Iowa that can reasonably be said to produce income." *American Home Products Corporation v. Iowa State Board of Tax Review*, 302 N.W.2d 140, 144 (Iowa 1981); *Internorth, Inc. v. Iowa State Board of Tax Review*, 333 N.W.2d 471, 475 (Iowa 1983).

[4]For the years 1975-1980, Shell's Iowa income tax returns disclosed that Shell computed its Iowa taxable income under

(Continued on following page)

resulted in the taxation of Shell's income derived from the OCS and was in violation of the Outer Continental Shelf Lands Act (OCSLA), 43 U.S.C. §§ 1331 *et seq.* (J.S. App. 65a-66a; Stip. par. 43). An administrative hearing was held on Shell's protest. Shell's calculation of its alleged OCS earned income from the extraction of oil and gas on the OCS was never conceded by Iowa and, in fact, was disputed. (MDA. App. Exhibit N; pars. 3-10). Shell's evidence consisted of its calculation of its alleged OCS net income figure by its separate accounting method and its assertion that, absent such calculation and deduction of that income figure from the unitary net income base, Iowa taxed Shell's OCS income in its assessment. Shell did not present any evidence with respect to its Iowa profits or profits from any other non-OCS portion of its unitary business. The administrative decision contained a finding that Shell failed to prove that the assessment taxed its OCS income. (J.S. App. 71a-72a; par. 11). The administrative decision found that the assessment did not violate the OCSLA.

Shell petitioned the Polk County District Court for judicial review of the administrative decision. That Court

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(Continued from previous page)

three different methods. (MDA. App. Exhibit N, par. 7). Two of the three methods did not involve any modification of the unitary net income base. For 1977, 1978, and 1979, Shell calculated its Iowa taxable income by the method described in page 27a of the appendix to the Jurisdictional Statement that depicts its modification to the Iowa unitary business/formula apportionment method. The Department of Revenue audit uniformly included all of Shell's operating unitary net income in the apportionable income base and attributed a portion of that income to Iowa by the Iowa sales formula, the numerator of which contains Shell's Iowa sales and the denominator of which contains Shell's sales in the rest of the world.

held that the OCSLA prohibited state extraterritorial taxation of the OCS, but did not prohibit a tax related to activities in the taxing state. (J.S. App. 33a). The Court found that Shell was not subjected to extraterritorial taxation.

The Iowa Supreme Court affirmed the decision of the District Court on Shell's appeal with respect to the OCS issue.[5] The Court rejected Shell's claim that the OCSLA inherently required an exclusion of a computed OCS net income figure from the unitary net income base. (J.S. App. 9a). The Court held that in an analysis of the OCS issue, the focus should be on the "tax consequences" produced by the apportionment, and not the components included within the unitary business/formula apportionment. (J.S. App. 13a). The Court did not view the exclusion by Florida of Shell's actual OCS revenues in the apportionment to justify a different result in the instant case in which actual revenues from the sales by Shell of natural gas at OCS wellheads were included in the apportionment.[6] (J.S. App. 10a). The Court concluded (J.A. App. 13a):

> The inclusion of OCS revenues in gross sales for purposes of applying the statutory apportionment

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[5]Shell prevailed on its contention that the assessment with respect to years 1975, 1976, and 1977 was untimely under provisions of Iowa law. The decision on this contention is unrelated to the issue before this Court.

[6]The Court agreed with the Florida Supreme Court's decision in *Shell Oil Co. v. Department of Revenue*, 496 So.2d 789 (Fla. 1986), in which that Court rejected Shell's interpretation of the OCSLA and held that a state unitary net income base which included sales outside of the OCS of minerals extracted in the OCS did not implicate the OCSLA.

> formula contained in Iowa Code section 422.33 (2)(b)(4) apparently aids in obtaining an accurate measure of the tax to be imposed as a result of Shell's Iowa activities. That, of course, is the goal of any apportionment formula. We cannot attribute to Congress an intent to impede this legitimate goal in the absence of some compelling indication that such was its intention in passing the OCSLA. We fail to divine any such intention from either the legislative history or language of the Act. We conclude that the district court properly rejected Shell's petition for judicial review on this issue.

In its appeal to this Court, Shell has limited its challenge on OCSLA grounds only to the unitary net income base. (J.S. 12). The record in this case contains absolutely no evidence that would support any indication that the Iowa apportioned net income exceeds Shell's profits earned from its marketing activities in Iowa.

—o—

REASONS FOR DISMISSAL OR AFFIRMATION

In *Shell Oil Company v. Department of Revenue, State of Florida*, appeal pending, No. 86-1593 (filed Mar. 20, 1987), Florida and the Solicitor General enumerated reasons why Shell's interpretation of the OCSLA is wrong. Iowa agrees with Florida and the Solicitor General that the OCSLA does not implicate a state apportioned net income tax scheme associated with the sale outside of the OCS of minerals extracted in the OCS. Iowa disagrees with the Solicitor General's recommendation that probable jurisdiction should be noted.

Principles underlying state unitary business/formula apportionment methods are well entrenched.[7] The states, in imposing upon multistate businesses their fair share of a tax upon their incomes associated with taxing state activities, can resort to formula apportionment to divide the unitary net income base between the taxing state and the rest of the world. The Constitution does not require a uniform method to be used by all states in this task. State rejection of separate accounting, as proposed by Shell to compute an OCS net income figure, is upheld, particularly where, as in this case, the taxpayer has made no effort to show that a facially reasonable apportionment method has resulted in taxation in excess of profits earned from activities within the taxing state. An allegation that a state tax operates to tax profits earned outside the state which is grounded upon a separate accounting method as proof is unfounded where, as in this case, Shell's separate accounting fails to consider contributions to income resulting from functional integration, centralized management, and economies of scale. Accordingly, if Shell's claim that Iowa taxed its OCS net income was founded upon Due Process or Commerce Clause analysis, Shell could not prevail. *Container Corporation of America v. Franchise Tax Board*, 463 U.S. 159 (1983); *Exxon Corp.*

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[7]When the OCSLA was adopted in 1953, this Court had firmly established the states' ability to require multistate businesses to divide their unitary net income bases by formula apportionment to reach results reasonably related to activities of the taxpayer in the taxing state. *Butler Brothers v. McColgan*, 315 U.S. 501 (1942); *Norfolk & Western Ry. v. North Carolina ex rel. Maxwell*, 297 U.S. 682 (1936); *Kent-Coffey Mfg. Co. v. Maxwell*, 291 U.S. 642 (1934), *aff'g per curiam* 204 N.C. 365, 168 S.E. 397 (1933); *Bass, Ratcliff & Gretton, Ltd. v. State Tax Commission*, 266 U.S. 271 (1924); *Underwood Typewriter Co. v. Chamberlain*, 254 U.S. 113 (1920).

v. Wisconsin Department of Revenue, 447 U.S. 207 (1980)[8]; *Moorman Manufacturing Company v. Bair*, 437 U.S. 267 (1978); *Butler Brothers v. McColgan*, 315 U.S. 501 (1942); *Underwood Typewriter Co. v. Chamberlain*, 254 U.S. 113 (1920).

Shell seeks to sidestep the aforementioned apportionment precedents of this Court. In essence, Shell states that it need not prove that the amount of its net income apportioned to Iowa exceeds its Iowa profits. (J.S. 12). In Shell's view, all that it need show for relief under the OCSLA is an "income earned" figure that "is the increment of income that represents the net value at the wellhead . . . of the OCS production," (J.S. 2, n. 1), and that this calculation is used by Shell for other legitimate purposes. (J.S. 6). Upon the basis of Shell's separate accounting OCS net income computation, Shell maintains that its OCS net income is included in the overall unitary net income base and Iowa, by applying its apportionment formula to that base, has taxed at least some of that OCS net income so that the OCSLA is violated.[9]

The fundamental flaw in Shell's theory in this case is its assumption that Iowa, in fact, taxed its OCS income. There is no finding below that such taxation actually occurred and the record will not support one. In reviewing Shell's appeal, this Court would be guided by a record that would only support a finding that the Iowa unitary business/formula apportionment method "reached, and was meant to reach, only the profits earned within the State." *Underwood Typewriter*, 254 U.S. at 121. Shell's assertion that Iowa taxed its OCS "earned income" is as speculative as the taxpayer's assertion that its non-Iowa earnings were taxed in *Moorman Manufacturing Company v. Bair*, 437 U.S. 267 (1978).[10]

Even assuming, arguendo, that Shell's calculation of its OCS net income is correct (an assumption not grounded upon any finding of fact below in this case), Shell's argument that Iowa inevitably taxed a portion of that income is fundamentally flawed based upon the record in this case. "Obviously, all sales are not equally profitable." *Moorman*, 437 U.S. at 276. Shell's sales in Iowa may have yielded a much higher amount of Shell's profits than the apportioned profits. *Id.* If so, there would be no basis for any claim that Iowa taxed any OCS income. *Id.*

The unitary business/formula apportionment method utilizes a preapportioned unitary net income base that would include income from a variety of activities within and without the state. According to the Iowa Supreme Court, the apportionment formula selected by Iowa "aids in obtaining an accurate measure of the tax to be imposed

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[8]In *Exxon*, this Court rejected the very separate accounting method that Shell has used to compute an OCS "production income" as proof that the state extraterritorily taxed that "production income."

[9]Shell advocates its position here where the record does not show that the Iowa apportionment result exceeds profits that Shell earned as a result of its Iowa activities.

[10]Although *Moorman* is a Due Process and Commerce Clause precedent and this case revolves around the Supremacy Clause, the differences between these Constitutional provisions should not require different factual assumptions when claims are made that the taxing state is taxing income earned outside the state. The record either shows that Iowa taxed Shell's OCS net income or lacks such an evidentiary showing. It is absurd and illogical to conclude that, for Due Process and Commerce Clause purposes, the record fails to evidence an Iowa tax upon Shell's OCS net income, but such evidence somehow exists for OCSLA purposes.

as a result of Shell's Iowa activities." (J.S. App. 13a). There is no contrary evidence in the record to dispute the Court's statement. The makeup of the unitary net income base and state taxation of activities outside the taxing state are not inherently identical concepts, despite Shell's attempt to make them so. Even if Shell's assumption that its OCS "earned income" is included in the unitary net income base is valid, it falls short of proof that the Iowa apportioned result taxed a portion of that earned income in the absence of a showing that the Iowa apportioned result exceeded Shell's profits from its Iowa activities.

Accordingly, Shell's claim that Iowa taxed its OCS income earned from extraction of oil and gas is purely hypothetical. A substantial federal question grounded upon a constitutional claim of state taxation of income earned outside the taxing state is not raised when the claim is hypothetical. *United States v. Raines*, 362 U.S. 17 (1960). *See also Moorman Manufacturing Company v. Bair*, 437 U.S. 267 (1978).

Since Shell cannot base its appeal in this case on any established fact that Iowa taxed its OCS net income, the only other basis for its claim for alleged violation of the OCSLA by Iowa is Shell's interpretation of the OCSLA that some sort of OCS income calculation must be made and deducted from the unitary income base and that OCS factors must be excluded from the apportionment formula. Within the context of this case, the issue is whether the OCSLA requires a modification of a state unitary business/formula apportionment method which has produced

a taxable net income that does not exceed the profits earned by the taxpayer in the taxing state.[11]

Taxation is a fundamental power, without which a state could not exist. Traditionally, this Court has been reluctant to disturb the distribution of powers between the states and the federal government. *United States v. Bass*, 404 U.S. 336, 349 (1971). "An intention to disturb the balance is not lightly to be imputed to Congress." *Apex Hosiery Co. v. Leader*, 310 U.S. 469, 513 (1940). Thus, pre-emption of state law by federal law "is not favored in the absence of persuasive reasons—either that the nature of the regulated subject matter permits no other conclusion or that Congress has unmistakenly so ordained." *Commonwealth Edison Co. v. Montana*, 453 U.S. 609, 634 (1981). Application of these principles to the instant case forecloses any interpretation of the OCSLA that would effectively restrict the fundamental power of states to tax income earned by activities within their borders.[12] Congress has not clearly expressed its intention for such restriction.

A significant indication that the OCSLA does not authorize Shell to reduce its Iowa apportioned net income attributable to its Iowa activities is the lack of any standards in the OCSLA for income attribution to the OCS.

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[11]The issue in this case becomes whether the OCSLA operates to shelter some of Shell's Iowa profits from Iowa taxation.

[12]This Court has recognized that a federal statute which provides for expansive exemption of federal obligations from state taxation should not be extended to create a "tax shelter" for subjects that are not federal obligations. *First National Bank of Atlanta v. Bartow County Board of Tax Assessors*, 470 U.S. 583, 597 (1985).

This Court could not develop any such uniform standards. *Moorman,* 437 U.S. at 278-9. There is no uniformity with respect to a separate accounting calculation of OCS income. *Thor Power Tool Company v. Commissioner of Internal Revenue,* 439 U.S. 522, 544 (1979). Moreover, nothing in the OCSLA would prevent each state, if Shell's position is adopted, from selecting its own and distinct separate accounting technique to compute an OCS net income figure, given the range of possible separate accounting techniques. In addition, different taxpayers could offer different separate accounting methods to compute an OCS "production income." This disharmony in the determination of OCS "production income" adds nothing to the policies underlying the OCSLA. Even if Shell's separate accounting technique is a useful tool for a variety of purposes, Shell has not been delegated the authority to prescribe a separate acounting method that other taxpayers and all states must follow.

Shell's separate accounting is merely its imperfect method of attempting to estimate an OCS net income figure for a segment of its unitary business. This imperfect method does not ensure the avoidance of any possible taxation by Iowa (or any other state) of any OCS net income since, by reason of the unitary nature of Shell's business, it is not possible to precisely source Shell's net income between OCS and non-OCS areas. Therefore, the "remedy" offered by Shell in this case of its internal accounting technique may be no remedy at all.[13]

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[13]Oil producers do not agree among themselves whether a "production income" that truly represents income associated with oil production can be accurately computed. In *Atlantic*

(Continued on following page)

The OCSLA clearly applies to those attempts by states to project their taxing authority into the OCS as if it were included within the borders of the taxing state. For example, any attempt by a state to impose a severance tax upon OCS production, a sales tax upon OCS wellhead sales, or a property tax upon OCS property would be clearly prohibited. In these instances, the activity or event in the OCS is taxed. Also, a state unapportioned income tax levied upon income-generating activities in the OCS would be proscribed. By contrast, a state apportioned tax associated with non-OCS activities in the taxing state, such as the Iowa unitary business/formula apportionment tax structure, does not inherently tax OCS activities, merely because OCS revenues and expenses are included within the apportionment.

A distinction between the Iowa *Shell* case and the Florida *Shell* case is that Florida excludes OCS wellhead sales to third parties from the unitary net income base and from the denominator of its apportionment formula sales factor while such sales are included by Iowa in the unitary net income base and in the sales formula denominator.

(Continued from previous page)

Richfield Co. v. Alaska, 705 P.2d 418 (Alaska 1985), appeal dismissed, 106 S.Ct. 774 (1986) (Burger, C.J., and White and Stevens, JJ., dissenting), the Alaska Supreme Court had upheld a tax computed upon Alaska "production income." The oil producers who challenged the tax alleged that formula apportionment, not separate accounting, should have been used to reasonably establish their Alaska income. As previously pointed out, note 4, *supra,* Shell, itself, did not uniformly determine its Iowa apportioned income on its Iowa tax returns. Also, in the vast majority of states in which Shell files income tax returns, Shell does not exclude from its unitary net income base any computed OCS net income. (J.S. App. 61a; Stip. par. 25).

According to Florida, these exclusions are "founded solely upon provisions of the Florida Income Tax Code and not upon possible pre-emption attributable to a federal statute." (Fla. MDA. App. 14-14). Iowa has no such statutory provisions.

The inclusion of Shell's OCS wellhead third party sales in the unitary net income base and in the denominator of the Iowa formula and the Iowa taxation of any OCS profits are two distinct subjects; the former does not inevitably cause the latter. The Iowa Supreme Court recognized this distinction in noting that inclusion of OCS wellhead sales "aids in obtaining an accurate measure of the tax to be imposed as a result of Shell's Iowa activities." (J.S. App. 13a).

The Solicitor General, in No. 86-1593, states that the effect of the OCSLA "is thus to codify the constitutional proscriptions, set forth in the Due Process and Commerce Clauses, against state efforts to tax values that lie outside their jurisdiction." (U.S. Brief, 16). Iowa agrees. For Due Process and Commerce Clause purposes, the actual location or source of a sale consummated outside the taxing state is irrelevant.[14] Such sales location is not logically a determinant in measuring the value of the local tax base. The locus of Shell's natural gas sales does not inevitably dictate whether the Iowa tax is imposed upon a net income base that exceeds Shell's profits earned in Iowa. It is only this excess that could fall within OCSLA forbidden state extraterritorial taxation.

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[14]It is precisely because of the irrelevancy of the "source" of these sales that formula apportionment is resorted to by states to ascertain an estimate of the taxable value of profits incurred by activities in the taxing state.

Given the Solicitor General's statement that the OCSLA codifies constitutional guarantees against state extraterritorial taxation, it would be inconsistent for him to conclude that Iowa taxed Shell's OCS wellhead sales income merely because that income was included in the unitary net income base and in the denominator of the formula. (U.S. Brief 6, 16, 17). A determination whether the Iowa tax is imposed upon an income base in excess of Shell's Iowa profits cannot rest upon a factual foundation of whether sales of OCS minerals were consummated in the OCS or at some other non-Iowa location. Even Shell admits that the location of its sales is irrelevant for OCSLA analysis. (J.S. 23). The arbitrary standard of sales location to determine application of the OCSLA to state apportioned net income taxes would be exacerbated by the fact that contractual provisions between gas producers and pipeline companies differ. *Maryland v. Louisiana*, 451 U.S. 725, 730 (1981). These differences could cause otherwise similar gas sales to be consummated at different locations, some of which would be in and others off the OCS.

Shell asserts that the Solicitor General's position is that a state cannot include within its unitary net income base any profits from OCS wellhead sales to third parties. (J.S. 21). Iowa believes that this assertion is a distortion of the Solicitor General's position. The Solicitor General's position was that a state was prohibited by the OCSLA from taxing the earnings from OCS wellhead sales. (U.S. Brief, 6, 16, 17). This position is consistent with his conclusion that the OCSLA codified Due Process and Commerce Clause guarantees against state extraterri-

torial taxation.[15] (U.S. Brief 16). The Solicitor General believed that Iowa opined that it could tax OCS earnings. (U.S. Brief 17, n. 12). In fact, Iowa has not been of that opinion and the Iowa Supreme Court's decision did not approve of a tax imposed upon Shell's OCS earnings. Iowa takes the position that the OCSLA does not limit Iowa taxation of Shell's Iowa profits. That is how the Iowa Supreme Court perceived this case. (J.S. App. 13a). The Solicitor General's Brief disapproved of state taxation of OCS earnings, but the Brief did not condemn, and instead supported, the Iowa effort of inclusion of OCS revenues and expenses in the unitary business/formula apportionment in order to attain "an accurate measure of the tax to be imposed as a result of Shell's Iowa activities." (J.S. App. 13a).

The legislative history concerning the OCSLA clearly reveals that proponents and opponents of state taxation in the OCS wanted statutory language which would address the contours of state jurisdiction—or lack thereof—in the OCS area.[16] In short, Congress intended to codify a state

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[15]Florida's decision to exclude income from OCS wellhead sales from the unitary net income base and Florida apportionment formula does not detract from the notion that the location of sales outside the taxing state does not inevitably dictate whether the state is taxing earnings incurred outside of the state. Florida is free to elect these exclusions. States are not required to uniformly define the scope of the unitary income base or the factors in the apportionment formula. *Container Corporation of America v. Franchise Tax Board*, 463 U.S. 159, 167 (1983); *Moorman Manufacturing Company v. Bair*, 437 U.S. 267 (1978). Such uniformity is not required by the OCSLA.

[16]In *United States v. Louisiana*, 339 U.S. 699 (1950) and in *United States v. Texas*, 339 U.S. 707 (1950), this Court established the exclusive authority of the United States in the OCS to the exclusion of the States.

tax policy whereby state taxation was permitted or was prohibited. Ultimately, Congress chose the policy of state tax proscription in the OCS. These tax prohibition signals are in 43 U.S.C. § 1333(a). Shell argues that an interpretation of the OCSLA of codifying Due Process and Commerce Clause prohibitions against extraterritorial taxation renders the statute "superfluous" and "trivializes" the Congressional effort. (J.S. 23). Within the context of the Congressional debates, namely, the desire to address state taxation in the OCS, it cannot be said that an interpretation of the OCSLA to codify Due Process and Commerce Clause state tax proscriptions is "superfluous" or "trivial."

———o———

CONCLUSION

Probable jurisdiction should not be noted. Shell's appeal should be dismissed or the decision of the Iowa Supreme Court should be affirmed.

Respectfully submitted,

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APPENDIX

EXHIBIT N

BEFORE THE IOWA STATE
DEPARTMENT OF REVENUE
HOOVER STATE OFFICE BUILDING
DES MOINES, IOWA

IN THE MATTER OF:	)	
	)	AFFIDAVIT
SHELL OIL COMPANY	)	OF JOHN
P. O. Box 2463	)	CHRISTENSEN
Houston, TX 77001	)	
	)	DOCKET NO.
CORPORATE INCOME	)	82-157-2A-A
TAX ASSESSMENT	)	

STATE OF IOWA)
) ss
COUNTY OF POLK)

JOHN CHRISTENSEN, of full age, being duly sworn according to law, upon his oath deposes and states:

1. My name is John Christensen. I received a B.A. degree in accounting in 1970 and an M.A. degree in business education in 1971 from the University of Northern Iowa. In September of 1973, I became a certified public accountant (CPA) and am so today. I commenced work with the Iowa Department of Revenue in September, 1972, wherein I audited Iowa corporate income tax returns in the Department's Corporate Audit Section. In October of 1976, I became supervisor of that section. In November of 1983, by reason of the Department's reorganization, I became a Technical Tax Specialist III in the Department's new policy section, with responsibilities associated with the Iowa corporate income tax and the Iowa franchise tax (imposed on financial institutions). I have had extensive audit experience, both office audit and field audit, of cor-

porate income tax and franchise tax returns. In this regard, I have to be familiar with various accounting methods used by various industries, including oil companies. Since Iowa corporate income tax and franchise tax net income is referenced to federal taxable income, with certain adjustments, I have also been required to have a general familiarity with the Internal Revenue Code. Over the years, I have been involved in a number of corporate income tax audits of oil companies doing business in Iowa. I am a member of the American Institute of Certified Public Accountants and of the Iowa Society of Certified Public Accountants.

2. I am familiar with the Stipulation in the instant contested case, Docket No. 82-157-2A-A, as it pertains to Shell's purported method of a separate accounting computation of its alleged net income from the outer continental Shelf (OCS), including the Schedule E exhibits.

3. In Shell's separate accounting method for OCS purposes, Shell appears to be using a functional approach, rather than a geographical approach. Under generally accepted accounting principles, a portion of Shell's refining and sales expenses associated with refining and sale of OCS minerals could be attributable to the OCS. Conceivably, these costs could be determined, if the data exists, on a per barrel basis. Shell's separate accounting method for the OCS does not attribute any refining and sales expenses to the OCS.

4. The refining and sales expenses associated with OCS minerals could, for example, be determined as follows, using a barrel formula:

$$\frac{\textit{barrel from OCS}}{\text{Total barrels}} \times \text{total refining costs} = \text{refining expenses attributable to OCS}$$

$$\frac{\text{Barrels of finished OCS products}}{\text{total barrels of finished products}} \times \text{total selling expenses} = \text{selling expenses attributable to OCS}$$

The results reached, however, by use of the above formulas are simply an approximation of expenses attributable to the OCS. When these expenses, along with the others in the Schedule Es, are used to determine an alleged OCS net income, if any, the resulting computation is merely an estimate of OCS net income and would not prove that the results reached by application of the Iowa sales formula to Shell's total net income, as was done in the audit of Shell's returns by the Department to determine an Iowa taxable income, taxed any income which Shell earned from the OCS.

5. Shell's Schedule Es for each year in question (1975-1980) do not purport to establish Shell's federal taxable income or Iowa taxable income as set forth in Iowa Code § 422.35.

6. Shell's Schedule E for each year in question (1975-1980), while purporting to be a computation of Shell's federal taxable income for Shell's OCS segment, is not a computation of segment federal taxable income pursuant to federal income tax laws and regulations, since those laws and regulations do not require a taxpayer to compute a federal taxable segment income, but require a computation of federal taxable income on a company-wide basis.

7. For the years 1975-1980, Shell's Iowa income tax returns denote that Shell computed its Iowa taxable in-

come by use of three different methods. First, for years 1975 and 1976, Shell attributed a portion of its total operating net income to Iowa by use of a three factor property-payroll-sales formula, without any deduction from the preapportionment net income base for a computed and separately accounted for OCS net income figure. Second, for years 1977, 1978, and 1979, Shell attributed a portion of its operating net income to Iowa, after deduction of a computed and separately accounted for OCS net income figure from the preapportionment net income base, by use of a sales factor formula. Third, for 1980, Shell attributed a portion of its total operating net income to Iowa by use of a sales factor formula, without any deduction from the preapportionment net income base for a computed and separately accounted for OCS net income figure.

8. Under generally accepted accounting principles, no income or loss can be recognized until a sale outside of the corporate structure occurs as distinguished from Shell's transfers from its E & P Organization to Shell's Products Organization which were transfers within the same corporate structure.

9. Generally accepted accounting principles or methods are designed to compute a company-wide net income. In addition, there are various accounting methods which can be used by a corporation in an attempt to compute a net income for internal management purposes. There are not, however, any generally accepted accounting principles or methods which are designed to determine the geographical source of net income. While Shell's separate accounting, as disclosed in its Schedule Es, can be used for purposes of computing depletion allowance as a deduction for federal and Iowa income tax purposes, this computation

of the depletion deduction is simply a method to determine that deduction, and not a method to determine federal taxable income or Iowa taxable income attributable to the OCS.

10. The figures computed by Shell on the Schedule Es, line 40 for 1975 and equivalent lines for the other Schedule Es, do not purport to be a precise measure of Shell's profits from the OCS and do not purport to identify the precise source of Shell's OCS profits, if any. Shell's computed OCS net income is merely an estimate by Shell. It is impossible, by use of accepted accounting methods, to compute a precise amount of net income, if any, from Shell's unitary business attributed to the OCS. Generally accepted accounting principles are designed along functional lines, and not strict geographical lines.

11. In my opinion, Shell's separate accounting methodology does not demonstrate that for the years in question (1975-1980), the effect of the June 10, 1982 assessment (Exhibit 10) is to impose Iowa income tax upon Shell's net income, if any, from the OCS.

/s/ John Christensen
John Christensen
Technical Tax Specialist III
Iowa Department of Revenue

Subscribed and sworn to before me this 10th day of December, 1984.

/s/ Connie Hoffman
Connie Hoffman
Notary Public

Supreme Court, U.S.
FILED
JAN 25 1988
JOSEPH F. SPANIOL, JR.
CLERK

No. 87-984

In the Supreme Court of the United States

OCTOBER TERM, 1987

SHELL OIL COMPANY, APPELLANT

v.

THE IOWA DEPARTMENT OF REVENUE, APPELLEE

On Appeal from the Supreme Court of Iowa

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SHELL OIL COMPANY, APPELLANT

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On Appeal from the Supreme Court of Iowa

REPLY BRIEF FOR THE APPELLANT

As our jurisdictional statement demonstrated, and as the Solicitor General agrees in his amicus brief in this case (U.S. *Iowa* Am. Br. 7), this appeal presents a substantial federal question that warrants plenary review by this Court. The Outer Continental Shelf Lands Act is an important congressional statute governing our nation's off-shore leasing program, and the interpretation of the OCSLA's state tax prohibition will affect more than 40 states and numerous corporate taxpayers. Nothing in Iowa's motion to dismiss dispels the need for this Court's review or justifies a summary ruling on the merits.[1]

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[1] The Solicitor General also agrees (U.S. *Iowa* Am. Br. 7 n.2) that the Court should note probable jurisdiction in this case and hold the *Florida* case (No. 86-1593). See Shell *Iowa* J.S. 26-27.

I. Iowa devotes much of its discussion to a phantom issue. It repeatedly argues that "the Iowa apportioned net income [did not] exceed[] Shell's profits earned from its marketing activities in Iowa" (Mot. to Dis. 6). That proposition simply has nothing to do with the question presented in this case. If the income apportioned to Iowa did exceed Shell's profits from its activities in the State, that would establish a violation of the Due Process and Commerce Clauses, as Iowa recognizes (Mot. to Dis. 7). Instead of a constitutional claim, Shell's position here rests, as Iowa acknowledges (Mot. to Dis. 10), on "[an]other basis"—the OCSLA. That Iowa's apportionment formula in the abstract does not violate the Due Process and Commerce Clauses provides no answer to the question whether its application in these circumstances is prohibited by the OCSLA.

What is more, Iowa's apportionment methodology does, contrary to the State's assertion (Mot. to Dis. 10), "tax[] a portion of * * * [Shell's OCS] earned income." In all but one of the years reflected in the record (see J.S. 8-9 n.6), Iowa's inclusion of Shell's OCS income in the apportionable tax base increased the tax due the State. In effect, Iowa—and each of the other states that have a similar tax scheme—taxes a pro rata share of Shell's OCS income by attributing a portion of the net wellhead value of OCS oil and gas to Shell's transactions that occur in the State. While Iowa may have the constitutional power to value in-state transactions under that theory, there can be no doubt that in doing so the State has taxed Shell's OCS income. The question presented here is whether such taxation is inconsistent with the OCSLA.

With respect to that statutory question, Iowa argues (Mot. to Dis. 11) that the Court should be reluctant to disturb the State's taxing authority. But shibboleths about the states' "fundamental power" to tax (*ibid.*) are of no help in construing the OCSLA. That Congress was both aware of and intended to limit the

states' "fundamental power" is clear from the words of the legislation: "State taxation laws shall not apply to the outer Continental Shelf" (43 U.S.C. § 1333(a)(2)(A)), and the OCSLA "shall never be interpreted as a basis for [a state's] claiming any interest in * * * the property and natural resources * * * [of the OCS] or the revenues therefrom" (43 U.S.C. § 1333(a)(3)). The nature and extent of that congressional limitation on state taxation must be resolved by reference to the language, history, and policies of the OCSLA—none of which Iowa discusses.

Moreover, contrary to Iowa's pejorative characterization (Mot. to Dis. 11 nn. 11, 12), the OCSLA state tax prohibition does not create a "tax shelter" for federal lessees. As with the statute that forbids states from taxing the interest and dividend income from United States securities (31 U.S.C. § 3124(a); see J.S. 12), Congress in the OCSLA has effectively granted a federal immunity from state taxation of OCS income in order to further paramount national policies concerning the outer Continental Shelf. A congressional limitation on the taxing authority of the states, designed to promote and protect a constitutionally superior federal interest, is not to be disparaged as a windfall for the taxpayer. And in contrast to *First National Bank* v. *Bartow County Board of Tax Assessors*, 470 U.S. 583 (1985), upon which Iowa relies, Shell's interpretation of the OCSLA does not shield non-OCS income from state taxation. See 470 U.S. at 596 ("federal obligations [should not be] permitted to shelter taxable assets").

In the end, Iowa's position comes down to the argument that the OCSLA provides nothing more than the Commerce and Due Process Clauses already do: a prohibition against extraterritorial state taxation. As explained in our jurisdictional statement (at 23), that interpretation renders the statute superfluous and fails to recognize—as Congress itself understood, based on its

lengthy and frequently controversial debates over the matter—that the Act was intended to impose a significant additional restriction on the states.

Our construction of the OCSLA is not rebutted, as Iowa asserts (Mot. to Dis. 11-12), by the fact that the OCSLA does not set out detailed standards for computing the OCS income that is exempt from state taxation. Congress understandably could have left the formulation of such implementing standards to the courts (or the responsible federal agencies), just as it has done under 31 U.S.C. § 3124(a). Moreover, even if the determination of OCS income were made by the respective states, the potential for some variation in applying the statute would not be a fatal inconsistency with the OCSLA, provided that each state's methodology furthers rather than impairs the purposes of the Act. Iowa's solicitude for the federal interest in national uniformity is a flimsy—and an ironic—justification for allowing the 50 states *carte blanche* to include OCS income in the apportionable base on which their income taxes are laid.

2. Iowa and the Solicitor General have spawned much confusion concerning state taxation of income from on-Shelf sales of OCS oil and gas. Iowa contends (Mot. to Dis. 13-14, 16 n.15) that Florida's concession with respect to on-Shelf sales was " 'founded solely' " on state law and did not reflect the OCSLA. As the Florida Supreme Court explained, however, the State "concede[d] that any revenues which Shell derives from actual sales consummated on the OCS oil platforms are *beyond the reach of Florida's taxing power as limited by section 1333(a)(2) [of the OCSLA]*" (Shell *Florida* J.S. App. 1-8 (emphasis added)). In addition, the Solicitor General has recognized that Florida's concession was compelled by the OCSLA (U.S. *Florida* Am. Br. 6, 16, 17) and that—with specific reference to the instant case then-pending in the Iowa Supreme Court—any other interpretation of

the Act would be erroneous as a matter of *federal* law (*id.* at 17 n.12).

In his amicus brief in this case, the Solicitor General has raised a question about the meaning of Florida's concession and consequently about the substance of the federal government's legal position in the *Florida* case, which he contends we "misapprehended" (U.S. *Iowa* Am. Br. 1). As he now expresses his view, the Solicitor General believes that the OCSLA (and the Florida concession) simply precludes a state from taxing OCS income as though it were earned within the state's borders, but does not prohibit the inclusion of OCS income in the apportionable income base used in determining the tax due the state (U.S. *Iowa* Am. Br. 4, 5-6). Whatever else may be said about it, this interpretation—that the OCSLA does not apply to apportioned state taxes—cannot fairly be understood to be what the federal government presented to the Court in its *Florida* amicus brief.[2]

First, as the Florida Supreme Court's opinion indicates, Florida's concession was broad and unqualified. Nothing in the restriction that the State acknowledged on its "taxing power" (Shell *Florida* J.S. App. 1-8) excluded apportioned taxation.

Quite the contrary, the context in which Florida made its concession specifically involved apportionment. The tax that Florida seeks to impose—and that Shell opposes—is an apportioned income tax, not a tax that deems the OCS to be within the State's boundaries. Unlike the Solicitor General, Iowa has correctly understood that Florida's concession related to its exclusion of net "OCS wellhead sales to third parties *from the unitary net income base*" (Iowa Mot. to Dis. 13 (emphasis added); see also *id.* at 16 n.15).

---

[2] For the reasons outlined above and in our jurisdictional statement, the government's position gives a crabbed and meaningless interpretation to the OCSLA that fails to further the Act's policies.

Moreover, in light of the language and history of the OCSLA, there could be no reasonable doubt that the Act forbids Florida from extending its geographical jurisdiction to the OCS. If that is all that Florida and the Solicitor General intended to foreclose, it is much ado about nothing—an interpretation that is belied by the evident importance that both the State and the federal government have attached to their submissions.

Finally, and perhaps most revealingly, the Solicitor General's *Florida* amicus brief expressly observed (at 17 n.6) that the Iowa Supreme Court would be in "error" in this case if it allowed the taxation that Florida had conceded would be improper under the OCSLA. Surely Iowa could not claim—with a straight face—that it had geographical jurisdiction over the OCS a thousand miles away. There was simply no basis for the Solicitor General to have believed that Iowa sought to extend its geographical jurisdiction to the Atlantic Ocean and the Gulf of Mexico in order "to tax income from sales completed on the OCS itself" (U.S. *Iowa* Am. Br. 5 n.1 (emphasis omitted)).

Thus, it is disingenuous for the federal government to assert that it has not altered its views on the meaning of the OCSLA and the application of the Act to state apportionment of income from on-Shelf sales. That the government has found it necessary to change its position underscores the difficult and substantial nature of the question presented here and reinforces the need for this Court to grant plenary review.

CONCLUSION

For the foregoing reasons and those stated in our jurisdictional statement, probable jurisdiction should be noted in this case, and Shell's appeal in the *Florida* case (No. 86-1593) should be held pending decision in this case.

Respectfully submitted.

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CLERK

No. 87-984

In the Supreme Court of the United States

OCTOBER TERM, 1987

SHELL OIL COMPANY, APPELLANT

v.

IOWA DEPARTMENT OF REVENUE

ON APPEAL FROM THE SUPREME COURT OF IOWA

BRIEF FOR THE UNITED STATES AS AMICUS CURIAE

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QUESTION PRESENTED

Whether, for purposes of determining the amount of income of a multi-state corporation that may be apportioned to any one of the States in which it does business, the Outer Continenal Shelf Lands Act, 43 U.S.C. 1333(a), which provides, inter alia, that "State taxation laws shall not apply to the outer Continental Shelf," precludes the inclusion of income earned from the sale of oil and gas extracted from the Outer Continental Shelf in the pre-apportioned income base of the State's apportionment formula.

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In the Supreme Court of the United States

OCTOBER TERM, 1987

No. 87-984

SHELL OIL COMPANY, APPELLANT

v.

IOWA DEPARTMENT OF REVENUE

ON APPEAL FROM THE SUPREME COURT OF IOWA

BRIEF FOR THE UNITED STATES AS AMICUS CURIAE

INTEREST OF THE UNITED STATES

In response to this Court's invitation, the United States recently filed a brief as amicus curiae in *Shell Oil Co.* v. *Department of Revenue, State of Florida*, appeal pending, No. 86-1593, which raises the related question whether the Outer Continental Shelf Lands Act, 43 U.S.C. 1332(a)(2)(A), limits a State's authority to tax an apportioned fraction of income earned from the sale within the United States of oil extracted from the Outer Continental Shelf. This brief is submittted because certain statements made in appellant's jurisdictional statement in this case appear to misapprehend the views expressed by the United States in its brief in No. 86-1593, and because that brief contained a comment about the present case that was based on a factual misimpression by us concerning Iowa tax law.

STATEMENT

1. Appellant Shell Oil Company (Shell) is a Delaware corporation engaged in the unitary business of exploring for, refining and marketing oil and gas products (J.S. App. 7a, 16a-17a). Shell conducts its production activities within various States and on the Outer Continental Shelf (OCS) (*id.* at 20a, 48a). Shell sells all natural gas produced on the OCS at the platform on OCS lands (*id.* at 7a-8a). In

contrast, most of Shell's crude oil is transferred off OCS lands to pipelines for transport to the continental United States, where it is delivered to refineries or other manufacturing facilities (*id.* at 8a, 20a, 25a). Shell's principal business in Iowa during the years at issue consisted of marketing oil and chemical products that had been refined and manufactured outside Iowa (*id.* at 8a, 17a-18a).

The State of Iowa imposes an income tax, administered by appellee Iowa Department of Revenue (Iowa), on the apportioned share of "net income" that is "reasonably attributable to the trade or business within the state" (J.S. App. 8a, 95a-96a; see Iowa Code Ann. § 422.33(1), (2) and (2)(b)(4) (West Supp. 1987)). Under Iowa law, a corporation's "net income" is its taxable income for federal income tax purposes, as adjusted pursuant to Section 422.35 of the Iowa Code (J.S. App. 96a; see Iowa Code Ann. § 422.35 (West Supp. 1987)). The amount of total net income attributed to business conducted in Iowa is determined under a one-factor formula, which is based on the ratio of sales made in Iowa to gross sales everywhere (see Iowa Code Ann. § 422.33(2)(b)(4) (West Supp. 1987); J.S. App. 27a):

$$\frac{\text{Iowa Gross Sales}}{\text{Everywhere Gross Sales}} \times \text{Federal Taxable Income Adjusted Per Iowa Law} = \text{Iowa Income}$$

In computing the portion of its net income attributable to business done within Iowa for the years 1978 through 1980, Shell excluded from the net income subject to apportionment the amount it determined to represent actual or deemed earnings from OCS oil and gas production (J.S. 8; J.S. App. 27a). For oil and gas sold to third parties on the OCS, Shell excluded its gross receipts from those sales, less related costs and expenses. Where the oil was simply transferred to pipelines for transportation to shore, the

amount excluded consisted of the wellhead fair market value of the oil, less related costs and expenses (J.S. App. 21a, 27a; J.S. 2 n.1, 8 n.4). The result was the following adjustment of Iowa's one-factor formula:

$$\frac{\text{Iowa Gross Sales less OCS Gross "Sales" actually made and wellhead fair market value of oil transported to shore}}{\text{Total Gross Sales less OCS Gross "Sales" actually made and wellhead fair market value of oil transported to shore}} \times \text{Non OCS Taxable Income} = \text{Iowa Income}$$

The Iowa Department of Revenue rejected this modification to Iowa's apportionment formula, and issued a notice of assessment computing Shell's Iowa income in accordance with the apportionment formula established by Iowa law (J.S. App. 70a).

2. Shell contested the increase in tax in a hearing before the Iowa Department of Revenue. Shell contended that under the Outer Continental Shelf Lands Act (OCSLA), 43 U.S.C. 1333(a)(2)(A), it was entitled to exclude OCS revenues from its pre-apportionment net income base. The hearing officer rejected Shell's contention on the ground that the inclusion in the apportionment formula of income Shell attributed to its OCS activities, did not itself entail an application of Iowa's tax law to the OCS in contravention of OCSLA (J.S. App. 72a-74a, 37a).

3. The Iowa District Court for Polk County affirmed the final order of the hearing officer (J.S. App. 15a-35a). The district court concluded (*id.* at 32a-33a) that "Iowa's apportionment scheme does not tax income derived by Shell solely from the OCS. Rather, Iowa's indirect taxation of Shell's OCS income is directly attributable to Shell's sales within the State of Iowa."

4. The Iowa Supreme Court affirmed (J.S. App. 1a-14a). The court concluded (*id.* at 12a-13a) that neither the legislative history nor the language of OCSLA evidences a compelling indication that Congress intended to prohibit the apportionment of income derived from the sales of OCS oil and gas for the purpose of obtaining an accurate measure of the tax to be imposed on in-state business activities.

5. While Shell's appeal was pending before the Iowa Supreme Court, the Florida Supreme Court rendered a decision against Shell in a lawsuit similar to this one, holding that OCSLA does not limit Florida's authority to tax an apportioned share of income from the sale within Florida of oil extracted from the OCS. Shell appealed the decision of the Florida court to this Court. *Shell Oil Co.* v. *Department of Revenue, State of Florida*, appeal pending, No. 86-1593. The United States has submitted a brief as amicus curiae in that appeal in response to the Court's order inviting the Solicitor General to express the views of the United States. In that brief, we argue that OCSLA's provision (43 U.S.C. 1333(a)(2)(A)) that "[s]tate taxation laws shall not apply to the outer Continental Shelf" simply reflects congressional intent that the OCS be treated as an area of exclusive federal jurisdiction outside the borders of any State. We thus indicate that OCSLA precludes a State from taxing activities on the OCS in the same manner that the Constitution precludes a State from taxing activities in another State or in a foreign nation. It does not, we maintain, prohibit a State from taxing income derived in the State from the sale of oil and gas extracted from the OCS.

DISCUSSION

Shell contends in its jurisdictional statement that OCSLA precludes Iowa from including in its tax apportionment formula Shell's gross sales and its total income, unless there are eliminated therefrom sales made on the OCS and any income earned by Shell from the extraction

of OCS oil and gas. It argues that this prohibition applies both to the income it realized on sales of oil and gas completed on the OCS and to the value of OCS oil and gas (less expenses) transported to shore for sale there (J.S. 12). According to Shell, the inclusion of income derived from OCS oil and gas in Iowa's apportionment formula constitutes the application by Iowa of its tax laws to the OCS in contravention of the express language of OCSLA. This claimed violation of OCSLA is not contended to be a consequence of any deficiency in Iowa's statutory apportionment formula; Shell specifically disclaims any challenge to Iowa's apportionment scheme (*ibid.*).

In support of its position, Shell mistakenly attributes to the United States the view that "a decision sustaining *apportionment* of OCS income from sales on the Shelf would be in 'error' " (J.S. 11 (emphasis added)). To be sure, as Shell points out, the United States indicated in its brief as amicus curiae in No. 86-1593 that a State may not *tax* income earned from sales of OCS oil or gas that are completed on the OCS and further stated (at 17 n.12), with respect to the instant case, that "[i]f the Iowa Supreme Court were to uphold state taxation of earnings from OCS sales, that holding would appear to be error * * *."[1] The United States, however, contrary to Shell's claim here, did not express the view that the inclusion in a State's apportionment formula of income derived from OCS sales of oil or gas would constitute taxation by the State of such income in contravention of OCSLA.

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[1] At the time we filed our amicus brief in No. 86-1593, we were under the misimpression that Iowa law, unlike Florida law, purported to *tax* income from sales completed on the OCS itself (at 17 & n.12). The Iowa Supreme Court's subsequent decision in this case establishes, however, that Iowa does not purport to tax such income, but merely includes those sales in its apportionment formula to determine what values should be deemed local and, hence, subject to local tax. See J.S. App. 11a-13a.

Indeed, such a view would be fundamentally at odds with the decisions of this Court upholding, in general, the constitutionality of comparable state apportionment formulae. See, *e.g.*, *Container Corp. of America* v. *Franchise Tax Bd.*, 463 U.S. 159 (1983); *Exxon Corp.* v. *Dep't of Revenue*, 447 U.S. 207 (1980); *Mobil Oil Corp.* v. *Commissioner of Taxes*, 445 U.S. 425 (1980); see also *Moorman Mfg.* v. *Bair*, 437 U.S. 267 (1978). These decisions are founded on the principle that inclusion by a State in its apportionment formula of income from sales in other States does not, in itself, entail the taxation by the State of extraterritorial values. The basic function of an apportionment formula is to ascertain what values should be deemed local, and what values should be deemed extraterritorial, and to tax only the former, not the latter (*ibid.*). It follows from this principle that Iowa, in including OCS sales and income in its apportionment formula, has not, *ipso facto*, extended its tax laws to the OCS any more than its inclusion in that formula of sales and of income earned by Shell in another State or in a foreign country would necessarily constitute an application of its tax laws to that State or that country. Of course, it is a distinct question whether the *amount* of income attributed to Iowa by its apportionment formula exceeds the limitations imposed by the Due Process and Commerce Clauses on a state's apportionment of income derived from activities occurring in another jurisdiction (*ibid.*; cf. *Exxon Corp.* v. *Dep't of Revenue*, 447 U.S. at 227 n.11). We do not, however, understand Shell to undertake such a challenge here and, hence, we do not address that issue. See J.S. i, 7 & n.3, 12. But see *id.* at 21 & n.36.

For the reasons stated in our amicus brief in No. 86-1593 (at 5-10), we agree with the Iowa Supreme Court (J.S. App. 13a) that, absent a clear indication to the contrary in the legislative history, OCSLA should not be construed as precluding Iowa from utilizing Shell's OCS income in the measurement of the tax to be imposed on Shell's Iowa activities. And, like the Iowa court, we also

believe that the legislative history contains no such contrary indication (see 86-1593 U.S. Amicus Br. at 11-16). Nonetheless, for the reasons stated in our amicus brief in No. 86-1593, although we therefore believe that the decision of the Iowa Supreme Court is correct, we are unable to conclude that the federal question is completely "insubstantial" and hence think it would be appropriate for the Court to note probable jurisdiction.[2]

Respectfully submitted.

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JANUARY 1988

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[2] Should the Court decide to grant plenary review, it may wish to consider doing so only in the present case (while holding No. 86-1593) because this case, unlike No. 86-1593, involves sales both on and off the OCS.

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Supreme Court, U.S.
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No. 87-984

IN THE

Supreme Court of the United States

OCTOBER TERM, 1987

SHELL OIL COMPANY, APPELLANT

v.

THE IOWA DEPARTMENT OF REVENUE, APPELLEE

On Appeal from the Supreme Court of Iowa

JOINT APPENDIX

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JURISDICTIONAL STATEMENT FILED DECEMBER 15, 1987
PROBABLE JURISDICTION NOTED FEBRUARY 22, 1988

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IN THE IOWA DISTRICT COURT
FOR
POLK COUNTY

No. AA-952

SHELL OIL COMPANY,
Petitioner,

vs.

THE IOWA DEPARTMENT OF REVENUE,
Respondent.

RELEVANT DOCKET ENTRIES

DATE	PROCEEDINGS
12/18/85	Petition filed.
12/30/85	Affidavit of mailing.
12/30/85	Answer of Respondent.
1/22/86	Trial Certificate.
1/30/86	Certificate of Director of Revenue.
2/7/86	Order establishing schedule for conduct of proceeding.
4/29/86	Brief of Petitioner.
5/16/86	Application for protective order.
5/27/86	Defendant's Brief.
6/25/86	Reply Brief.
10/3/86	Ruling.
10/24/86	Notice of Appeal.

IN THE SUPREME COURT OF IOWA

No. 86-1565

SHELL OIL COMPANY,
Appellant,

vs.

THE IOWA DEPARTMENT OF REVENUE,
Appellee.

RELEVANT DOCKET ENTRIES

DATE OF FILING	DATE OF SERVICE	PROCEEDINGS
10/3/86		Judgment.
10/24/86	10/23/86	Information copy of Notice of Appeal by Hall.
10/24/86		Notice of Appeal by Hall.
10/28/86	10/27/86	Cert. of Ordering C.N.T. by Hall.
10/28/86	10/27/86	Statement re Child Custody—NO by Hall.
12/1/86	12/5/86	Docket Fee $50.00 by Hall.
12/1/86	11/26/86	Notice of Election to Defer Appendix by Hall.
1/20/87	1/16/87	Appellant's appl. for ext.—brief.
1/26/87	1/23/87	Appellant's motion for protective order.
1/27/87		Order ext. Appellant due 2/19/87.
1/30/87	1/29/87	Kelly-Springfield Tire motion to file amicus brief.

DATE OF FILING	DATE OF SERVICE	PROCEEDINGS
2/4/87	CRW	Order Kelly-Springfield may file amicus.
2/13/87	2/13/87	Amicus of Kelly-Springfield by Mossman.
2/17/87	2/16/87	Appellant's appl. for ext.—brief.
2/19/87	WWR	Order ext. Appellant due 3/4/87.
3/2/87	2/27/87	Designation of Parts by Hall.
3/2/87	2/27/87	Proof Copies.
3/3/87	3/2/87	Designation by Hall.
3/12/87	Harris	Order: Motion granted in part. *All trans. & appendix to be sealed.* Motion to seal briefs denied. Any briefs previously filed may be withdrawn to give Appellant opportunity to file appendix under seal and make appropriate reference to briefs which will not be under seal. Time ext. 30 days.
3/18/87	3/18/87	Appellee—Appl. for ext. of length of brief.
3/23/87	3/23/87	Appellee—Appl. for ext.—brief.
3/23/87	AAM	Order overlength denied. File 50 pp. Appellee by 4/6/87.
3/25/87	WWR	Order Appellee due 30 days after Appellant refiles brief or time in J. Harris papers.
4/20/87	4/20/87	Proof Copies.
4/30/87	4/28/87	Appellant—Appl. for ext.—reply brief.
5/1/87	4/30/87	Motion to consolidate oral argument w/87-278.

DATE OF FILING	DATE OF SERVICE	PROCEEDINGS
5/13/87	5/12/87	Proof reply.
5/13/87		Order ext. reply due 5/18/87. Motion to consol. per. R. 22 (Md. 5/22/87).
5/20/87	5/19/87	Appendix by Hall.
5/26/87		Request to transmit rem. record.
6/1/87	6/1/87	Appellee's Brief by Griger.
6/4/87	6/2/87	Appellant's Brief by Kennedy.
6/4/87	6/2/87	Reply Brief by Hall.
6/4/87	Retd. 12/14/87	Trial Court Papers and Certified Record.
6/9/87		18 gray covers for brief by Hall.
6/9/87	Neuman	Order: Motion to consolidate oral argument granted.
8/14/87	8/13/87	Motion to delay oral argument by Appellant.
8/20/87	WWR	Order: Motion to delay oral argument denied. Court is willing to interpose argument between the two, but unwilling to remove from Sept. submission.
9/17/87		Submission Date.
10/21/87		Opinion Filed by Carter.
11/23/87	11/19/87	Notice of Appeal to United States Supreme Court.
12/2/87		Letter from Griger—costs paid.
12/21/87		Notice of filing appeal in U.S. Supreme Court.
2/25/88		Probable Jurisdiction noted in U.S. Supreme Court.

IN THE IOWA DISTRICT COURT
FOR POLK COUNTY

DEPARTMENT OF REVENUE
CONTESTED CASE

Docket No. 82-157-2A-A

Polk County District Court
Case No. AA-952

SHELL OIL COMPANY,
One Shell Plaza
P.O. Box 2463
Houston, Texas 77001,
Petitioner,

vs.

THE IOWA DEPARTMENT OF REVENUE,
Respondent.

PETITION FOR JUDICIAL REVIEW

[Filed December 18, 1985]

COMES NOW the Petitioner and states:

1. Pursuant to Section 17A.19 of the Iowa Code, Petitioner does hereby Petition the Court for Judicial Review of a Final Order of the Iowa Department of Revenue, dated December 4, 1985, in the above-named contested case proceedings involving Petitioner, a copy of

which Order is attached hereto as Exhibit "A". The Final Order herein appealed from incorporated by reference a Proposed Order of the Hearing Officer in these proceedings, dated August 26, 1985. Shell hereby appeals from each and all of the Findings of Fact and Conclusions of Law adverse to Shell set forth or inherent in said Proposed Order and Final Order of the Department of Revenue.

2. The nature of the agency action appealed from is a dispute as to the correctness of the Department of Revenue's assessment dated June 10, 1982 against Shell for corporate income taxes for the tax years 1975 through 1980.

3. The particular agency action appealed from is the Order attached hereto as Exhibit "A".

4. This Petition is filed in Polk County District Court pursuant to Section 17A.19(2) of the Iowa Code, which allows for any Petition for Judicial Review under the Administrative Procedure Act to be filed in Polk County District Court.

5. The following is a summary of the grounds upon which Shell seeks relief:

(a) Outer Continental Shelf Lands Act Issue. The Outer Continental Shelf Lands Act, 43 U.S.C. § 1333 et seq., prohibits the state taxation of Shell's Outer Continental Shelf income. Shell claims that taxation of its Outer Continental Shelf income is in violation of the Outer Continental Shelf Lands Act and the Supremacy Clause of the United States Constitution.

(b) Statute of Limitations Issue. Shell also claims that the Notice of Assessment herein in issue, dated June 10, 1982, for the tax years 1975, 1976 and 1977, was not sent to Shell within the three-year limit established by Section 422.25(1) of the Iowa Code and none of the exceptions set out in 422.25 is applicable in this

case and therefore, that portion of the assessment is barred by said statute of limitations.

Each and all of Shell's grounds for relief are more particularly set forth in its Briefs filed in the contested case proceedings had before the Iowa Department of Revenue herein and said Briefs, including the detailed statement of Shell's grounds for relief are hereby incorporated by reference.

6. The relief sought by Shell is as follows:

(a) Elimination of the additional amounts of corporate income tax assessed against Shell for the tax years 1975, 1976 and 1977.

(b) A declaration that the taxation of Shell's Outer Continental Shelf net income is in violation of the Outer Continental Shelf Lands Act and the Supremacy Clause of the United States Constitution.

(c) An elimination from Shell's pre-apportionment net income of the net income attributable to the Outer Continental Shelf and an adjustment of Shell's Iowa corporate income tax consistent therewith.

A more detailed description of Shell's requested relief, including the amounts in controversy, appears in Shell's Briefs referred to above which are hereby incorporated by reference.

7. Shell asserts that the Order of the Director of the Iowa Department of Revenue herein appealed from and each and all of the Findings of Fact and Conclusions of Law of the Hearing Officer, whose Order is incorporated by reference in the Order of the Director of Revenue adverse to Shell, are in violation of applicable constitutional or statutory provisions; in excess of the statutory authority of the Department of Revenue; in violation of applicable rules of the Department of Revenue; were made upon unlawful procedure; contain various errors

of law; are unsupported by substantial evidence in the record made before the Department of Revenue when that record is viewed as a whole; and are unreasonable, arbitrary, capricious and characterized by an abuse of discretion or a clearly unwarranted exercise of discretion, in that additional assessment of corporate income tax against Shell for the tax years 1975, 1976 and 1977 is barred by the aforementioned statute of limitations and taxation of Shell's net income attributable to the Outer Continental Shelf violates the Outer Continental Shelf Lands Act and the Supremacy Clause of the United States Constitution.

WHEREFORE, Petitioner prays that the Court grant the relief herein sought and the Department of Revenue Order appealed from be reversed and modified accordingly.

SHELL OIL COMPANY

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Attorney for Petitioner

EXHIBIT "A"

BEFORE THE IOWA DEPARTMENT OF REVENUE
HOOVER STATE OFFICE BUILDING
DES MOINES, IOWA

Docket No. 82-157-2A-A

IN THE MATTER OF SHELL OIL COMPANY
One Shell Plaza
P.O. Box 2463
Houston, Texas 77001

CORPORATE INCOME TAX ASSESSMENT

ORDER OR DIRECTOR UPON REVIEW OF HEARING OFFICER'S PROPOSED ORDER

On September 23, 1985, the Iowa Department of Revenue (Department) filed an appeal to the Director of the Iowa Department of Revenue (Director), appealing the portion of the Hearing Officer's Proposed Order of August 26, 1985, which deleted paragraphs 22, 23, 24, and portions of paragraph 25 of the parties' Stipulation. On September 24, 1985, Shell Oil Company (Protestor) filed an appeal of the Hearing Officer's Proposed Order.

On October 4, 1985, the Director issued a Notice of Director's Review of Hearing Officer's Proposed Order, setting a review date of November 4, 1985. On October 14, 1985, the parties filed a Joint Agreement and Statement of Protestor and Department of Revenue.

The Director, having examined the record developed by the parties, hereby issues this Order.

STATEMENT OF THE CASE

The Director hereby adopts and fully incorporates into this Order the Statement of the Case as set forth in the Hearing Officer's Proposed Order.

FINDINGS OF FACT

The Director hereby adopts and fully incorporates as Findings of Fact the parties' Stipulation in its entirety. In addition the Findings of Fact numbered 47 through 51 in the Hearing Officer's Proposed Order are adopted and fully incorporated herein.

CONCLUSIONS OF LAW

The Director hereby adopts and fully incorporates into this Order the Conclusions of Law as set forth in the Hearing Officer's Proposed Order.

SUMMARY

The Director hereby adopts and fully incorporates into this Order the Summary as set forth in the Hearing Officer's Proposed Order.

IT IS THEREFORE ORDERED that the assessment of corporate income tax, interest, and fees as set out in the Notice of Assessment dated June 10, 1982, is affirmed. The Protestor failed to meet its burden of proof on the issues raised. With respect to the record developed by the parties, the evidence is more than substantial to support the factual and legal conclusions of this Order.

The Director's decision is the final Order of the Iowa Department of Revenue.

Issued at Des Moines, Iowa, this 4th day of December, 1985.

IOWA DEPARTMENT OF REVENUE

By /s/ G. D. Bair
G. D. BAIR
Director

IN THE IOWA DISTRICT COURT
FOR POLK COUNTY

No. AA-952

SHELL OIL COMPANY,
One Shell Plaza
P. O. Box 2463
Houston, Texas 77001,
Petitioner,

v.

THE IOWA DEPARTMENT OF REVENUE,
Respondent.

[Dated December 26, 1985]

ANSWER

COMES NOW, the Respondent, Iowa Department of Revenue, and for Answer to Petitioner's Petition for Judicial Review, states to the Court as follows:

1. Paragraph one (1) of the Petition is admitted.

2. Paragraph two (2) of the Petition is admitted.

3. Paragraph three (3) of the Petition is admitted.

4. Paragraph four (4) of the Petition is admitted.

5. For answer to paragraph five (5) and each subparagraph thereunder in the Petition, Respondent denies that Petitioner is entitled to any relief on the alleged grounds set forth and specifically denies that 43 U.S.C. § 1333 et seq. provides any basis for Petitioner's attempt, in these proceedings, to escape payment of Iowa corpo-

ration income tax on its net income associated with its Iowa activities of its unitary business. Further, Respondent denies that the three year limitation period in Iowa Code § 422.25(1) is applicable as alleged by Petitioner and, instead, the six months limitation in § 422.25(1) is applicable and Respondent's June 10, 1982 assessment was not untimely under the six months period

6. Paragraph six (6) and each subparagraph thereunder in the Petition are denied. Petitioner is not entitled to any relief that it seeks in the instant judicial review proceeding.

7. Paragraph seven (7) of the Petition is denied.

WHEREFORE, Respondent prays that, after notice and opportunity for hearing as provided by law for judicial review of a contested case proceeding, the Court affirm the final agency contested case decision.

/s/ Harry M. Griger
HARRY M. GRIGER
Special Assistant Attorney General
Hoover State Office Building
Des Moines, Iowa 50319
Telephone: 515-281-5846

Attorney for Respondent

IN THE IOWA DISTRICT COURT
FOR POLK COUNTY

(Title Omitted in Printing)

STIPULATION

[Dated December 11, 1984]

IT IS HEREBY STIPULATED that for the purposes of this case the following statements are made in lieu of oral testimony and all exhibits referred to herein and attached hereto are incorporated in this stipulation and made a part thereof; provided, however, that either party may introduce other and further evidence not inconsistent with the facts herein stipulated and provided further that either party may object to statements and exhibits in this stipulation on grounds of relevancy.

STIPULATION

I

GENERAL DESCRIPTION OF SHELL OIL COMPANY

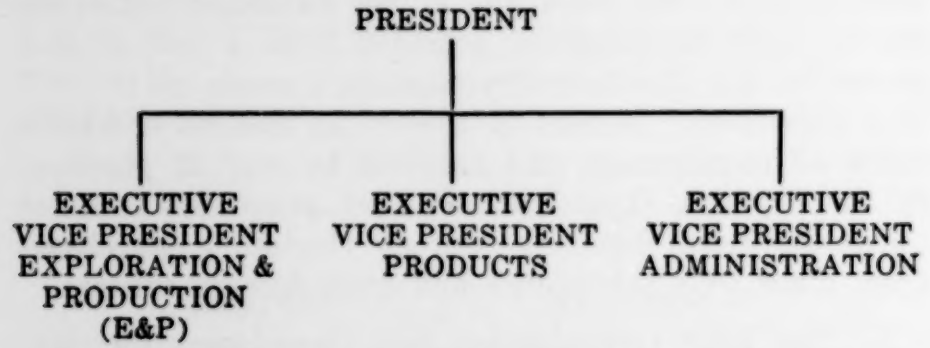
1. Shell Oil Company ("Shell") is a Delaware corporation with business operations in all fifty states and the District of Columbia.

2. During the years 1975 through 1980, Shell was the parent member of an affiliated group of corporations, the principal business of which is the exploration for,

and development, production, transportation, purchase, and marketing of crude oil and natural gas, and the purchase, manufacture, and marketing of oil and chemical products. Shell is a vertically integrated oil company which itself engages in the business activities set out above and also set forth in paragraph 4(b)(1) of the Protest and in Shell's annual 10K reports, Exhibits A, B, C, D, E, and F.

3. During the years 1975 through 1980 Shell Oil Company conducted the majority of its business activities as two separate operating organizations, the Products Organization and the Exploration and Production (E&P) Organization. Management was headed by a President. The President is the Chief Executive Officer of the Company with responsibility for the general and active supervision and management of the property, affairs, and business of the Company. There are three Executive Vice Presidents. Two of them are responsible to the President for their respective operating organizations, the Products Organization and the E&P Organization; the third Executive Vice President is responsible to the President for the staff organizations such as Legal, Tax, Finance, Employee Relations, and administers those functions as they apply to the other two organizations (E&P and Products). The E&P Organization is responsible for locating and acquiring rights to develop and produce crude oil, gas, and other natural resources. The production resulting from the E&P Organization's activities is Shell's major single supply of raw material. The Products Organization is responsible for the transportation, purchasing, and marketing of crude oil and natural gas liquids, and the manufacture and marketing of petroleum and chemical products. The Products Organization's products are refined and manufactured from feedstock (crude oil and natural gas) obtained from the E&P Organization or purchased from others. The Products Organization does not perform any functions on the Outer Continental Shelf (OCS).

The following is a diagram of the just-described portion of Shell's management which is located at Shell's offices in Houston, Texas.



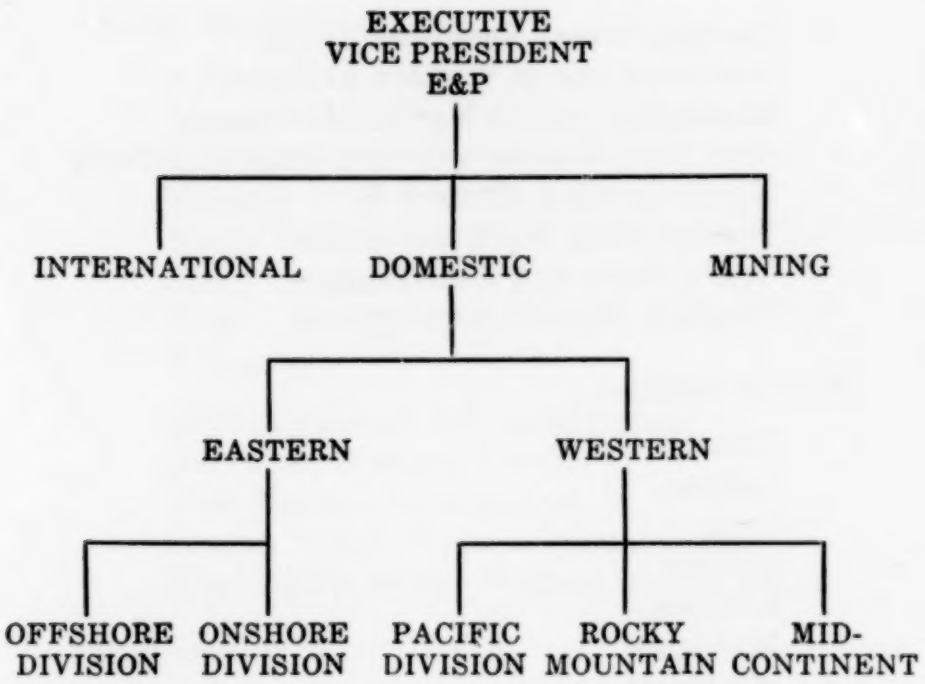
4. The Products Organization has two major operating segments; Oil Products and Chemical Products; it is headed by an Executive Vice President. The Oil and Chemical segments are each managed by a Vice President who has overall management responsibility for his business line and its sales function. There are three other segments of the Products Organization, the Operations and Technical segments which perform support functions; and the Special Projects segment which is responsible for special ventures involving the manufacture of selected petrochemical products in world-scale quantities. The Products Organization obtains part of its crude oil requirements from Shell's E&P Organization.

During 1975-80, for purposes of accounting for the transfers of crude oil production from Shell's E&P Organization to Shell's Products Organization, the transfers were recorded by Shell as sales at posted industry prices with appropriate adjustments for gravity* and transportation, but no money was paid for such intra-

* Gravity of crude oil is measured on the A.P.I. (American Petroleum Institute) scale. The lighter in weight the oil, the greater the A.P.I. gravity. Most crude oils range from 27° to 35° A.P.I. Other factors being equal, the higher the A.P.I., the better price the oil will bring.

company transfers. Such transfers at posted industry prices involved crude oil production in the OCS and non-OCS areas. See paragraph 23, *infra*. During the years 1975 through 1980 Shell was a "net purchaser" of crude oil, its E&P Organization provided from a low of 48.6 percent of the Products Organization's crude oil in 1977 to a high of 60.7 percent in 1980. The balance of Shell's crude oil requirement was acquired by way of purchase by the Products Organization. Such purchases included purchases from domestic sources (including purchases from other OCS producers) and from foreign sources.

5. The E&P Organization has three operating segments; Domestic, International and Mining. During the years at issue the domestic oil and gas segment was divided geographically between Western Operations and Eastern Operations and contained five divisions. The Offshore Division was one of the five divisions and was part of Eastern Operations and it was through the Offshore Division that Shell's Outer Continental Shelf operations were conducted. One of the other four divisions was in Eastern Operations, the other three were in Western Operations; they had primary responsibility for exploration and production in non-OCS areas in the United States. The general manager of the Offshore Division and his staff located in New Orleans, Louisiana, conceived and executed operational plans and managed the existing Shell assets on the Outer Continental Shelf (OCS). The general managers of the other divisions had similar responsibilities for, and exercised similar authority over, their respective divisions. The following is a diagram of the E&P Organization which represents the domestic segment.



The geographics areas covered by the various divisions were:

Offshore—Outer Continental Shelf;

Onshore—

Connecticut
Delaware
Florida
Louisiana
Maine
Massachusetts
New Hampshire
New Jersey
Rhode Island
South Carolina
Vermont

Alabama, Southern ½
Arkansas, Southern ½

Georgia, except Northwest corner
Maryland, except Western panhandle
Mississippi, except Northeast corner
New York, Southern tip and Long Island only
North Carolina, Eastern ⅔
Pennsylvania, Southeast corner
Texas, South and East Texas
Virginia, East of Appalachians

Mid-Continent—

Illinois
Indiana
Iowa
Kansas
Kentucky
Michigan
Minnesota
Missouri
Ohio
Oklahoma
Tennessee
West Virginia
Wisconsin —

Alabama, Northern ½
Arkansas, Northern ½
Colorado, Southeast corner
Georgia, Northwest corner
Maryland, Western panhandle
Mississippi, Northeast corner
Nebraska, except Western portion
New Mexico, Southeastern ⅔
New York, except Southern tip and Long Island
North Carolina, Western ⅓
Pennsylvania, except Southeast corner
Texas, North and West Texas
Virginia, Western edge

Rocky Mountain—

Arizona
Idaho
Montana
Nevada
North Dakota
South Dakota
Utah
Wyoming

Colorado, except Southeast corner
Nebraska, Western Portion
New Mexico, Northwestern ⅓
Oregon, except Western coastal region
Washington, except Western coastal region

Pacific—

Alaska
California

Oregon, Western coastal region only
Washington, Western coastal region only

The division's boundaries were determined principally by geographic and geological features rather than by state boundary lines.

6. During 1975-80, within the State of Iowa, Shell's principal business consisted of marketing oil and chemical products refined and manufactured by the Products Organization. There were crude oil based Shell-manufactured products sold in Iowa which were manufactured from crude oil which was commingled to the extent that the ultimate source (OCS or non-OCS) of the crude oil could not be determined with any degree of certainty. All of Shell's activity in Iowa was of such a nature that it fell within the purview of the Executive Vice President—Products. See paragraph 3, above.

7. Shell's activities as described in paragraph 2 of this Stipulation, including its activities on the OCS, constitute a unitary business, a portion of which, as stated in paragraph 6, was carried on within the state of Iowa during the years 1975 through 1980. Shell's activities are substantially similar to those described in the case of *Exxon Corp. v. Wisconsin Dept. of Revenue*, 447 U.S. 207 (1980).

II

OUTER CONTINENTAL SHELF OPERATIONS

AREA INVOLVED

8. Under the Outer Continental Shelf Lands Act (OCSLA), 43 U.S.C. § 1331, *et seq.*, the Outer Continental Shelf (OCS) is defined as "all submerged lands lying seaward and outside the area of lands beneath navigable waters as defined in section 1301 of this title, and of which the subsoil and seabed appertain to the United States and are subject to its jurisdiction and control." 43 U.S.C. 1331(a). Section 1301 of title 43 U.S.C. is part of the Submerged Lands Act (43 U.S.C. 1301 et. seq.) and defines "land beneath navigable waters" as essentially that area within three miles of the coast line of the United States. (Texas owns 3 marine leagues into the Gulf of Mexico.) In short, the Outer Continental Shelf is the submerged land, as defined in 43 U.S.C. § 1331(a), which lies beyond the 3-mile limit. Rather than being a geographic feature, as would be inferred from its name, the OCS is a legal term describing the land extending seaward from a state's offshore boundary under water over which the United States claims economic or territorial jurisdiction. As such the OCS is not located in the State of Iowa or any other of the 50 states, so during 1975 through 1980 the actual extraction of OCS minerals did not occur in Iowa or any of the other 50 states. The OCS surrounds the continental 48 states, Alaska and Hawaii.

9. The rights to explore for, develop and produce hydrocarbons (oil and gas) from beneath the OCS were conveyed by the federal government to private enterprises by way of lease sales. During the years at issue specific tracts of OCS land were selected to be the subjects of lease sales. The size of these tracts ranged from 750,000 to 1 million acres and the leases were usually in 5,000 or 5,760 acre blocks. The lease sale was advertised in the Federal Register at least 30 days before the sale with the sale date, place and time, the tracts to be offered, and the royalty amount (usually 1/6) set by the government. Since the royalty was set at 1/6 by the government the competition in any bidding was centered on the lease bonus. In determining the appropriate bonus, Shell included a factor in its computations to account for the burden of state income taxes on any income generated by the property. The Department does not agree that this computation is appropriate to demonstrate income, if any, earned by Shell on the OCS.

Pursuant to the terms of the sale, sealed bids were submitted. Prospective bidders could bid alone or in conjunction with others. An amount equal to 20% of the bid price had to be submitted with the bid and all of the procedural requirements of the bidding procedure had to be observed. Leases went to the highest bidder, but a property might not be awarded to the highest bidder if the bid price was less than what the government considered a fair price for the area. If all bids were rejected on an area, that area was usually open for bidding in the next lease sale. On a successful bid it could take up to 30 days to announce whether the tract had been awarded, but the announcement usually followed within two weeks of the opening of bids. Thereafter, the winning bidder had 30 days to submit the 80% of the bid price not deposited with the bid along with the first years' rent.

The successful bidder received an oil and gas lease pursuant to the terms advertised in the announcement of the sale. Generally, the terms of the lease provided for a 1/6 royalty and gave the successful bidder the exclusive right to explore, develop, and produce petroleum from beneath the area awarded. The initial term (that time period during which actual extraction of gas or oil must begin) was usually five years. There was generally a rental provision of $3 per acre per year. Rent was to be paid each year in advance during the initial five year period or until the start of production; after production started the rent would be paid in the form of a royalty based on production.

The term of the lease was to run for as long as there was production; absent production the lease would expire at the end of the five year initial term. The lease would of course terminate on abandonment or surrender by the leasee. Upon termination of the lease for any reason, the structures built thereon were to be removed and any wells to be plugged and abandoned in accordance with government regulations.

The leasing procedure for OCS leases is different from onshore leasing procedure. On land large lease areas can be acquired only where there are large individual or corporate landowners or where a number of smaller parcels of land can be assembled. In the face of competition for mineral properties it is extremely difficult to assemble a large block of small lease areas. On land the terms of the lease will vary depending on the bargaining positions of the parties, and allowable time prior to production usually will be shorter than that allowed for OCS leases.

Shell has onshore leases or owns land from which it extracts oil and gas and which is not part of the OCS. Shell was and is constantly exploring for oil and gas in non-OCS areas.

EXPLORATION

10. The following description sets out Shell's activities pursuant to the OCS leasing procedures in effect during the years at issue. These leasing procedures pertain to Shell's leasing of mineral rights on government lands in the OCS from the Federal government. The Offshore Division's (Offshore) activities with respect to an offshore lease usually commenced with a response to a government call for information regarding tracts set out in the Government's plan for leasing in a specific geographic area. The call for information usually occurred about two years before the tracts in question were to be the subject of a lease sale. The response to the call for information was an outline of a large general area of interest that Offshore would like to see come up for sale. Prior to the initiation of area-wide offshore sales in 1983, each prospective bidder would nominate individual tracts and only those tracts that received more than one nomination were put up for sale. In area-wide sales all the tracts in a defined area are put up for sale so a bidder does not have to wait until at least one other bidder also recognizes the hydrocarbon potential under a tract before it is put up for lease. In the years at issue (1975-80) the areas of interest were identified by actual lease block and by relative degree of desirability of the area; present practice is to describe the areas of interest by general geographic location.

11. Prior to the call for information, Offshore geophysicists would work up potential prospects using the existing seismic data relating to the general region of interest. The existing data may have contained seismic information generated in the course of Offshore's prior activities in the general area and information purchased from others engaged in commercial seismology. In addition, geophysicists would generate further seismic data in an attempt to locate geologic structures favorable to the accumulation of hydrocarbons. The additional seismic

data was acquired by specially equipped ships towing an air gun which is used to "shoot" in the areas of interest. "Shooting" consists of systematically transmitting pulses of energy (analogous to sound waves) and receiving reflected or refracted waves from the rocks below the seabed. [This differs from onshore 'shooting' in that on land the pulses of energy may be transmitted directly to the land with a device that delivers a shock to the earth's surface in the manner of a hammer, or dynamite may be used to generate the energy pulse.] Normally a one-mile grid of seismic data or profiles is obtained over the area of interest while sweeping a series of parallel lines, or lanes, in a shipborne seismic survey. The seismic profiles generated enable geologists and geophysicists, 1) to obtain a subsurface map of the geological structures, if any, underlying the area of activity, and 2) to project the distribution of sands (reservoir rock) from previous wells, if any, drilled nearby.

12. The foregoing activities were completed by approximately one year before the area of interest was planned to be the subject of a lease sale. About one year prior to the lease sale, when the sale areas were announced, the activity narrowed to the announced sale areas, and more geologic and seismic data was collected to narrow the search even further. By approximately six months prior to a planned lease sale the manpower and effort devoted to the study of specific areas or tracts increased and the number of areas which are the subject of the study decreased so that there was a greater concentration effort. The effort was principally in two areas, geologic and seismic. The geologic study dealt with defining the character of the reservoir rock; and the seismic study dealt with the determination of the characteristics of the reservoir and defining the overall reservoir structure and its complexities.

13. After the geologic and seismic data had been gathered, Offshore conducted review processes to determine which of the lease sale tracts was most promising for development and production. The potential net feet of hydrocarbons, productive area, type of hydrocarbons anticipated (oil, gas or both), recovery factors and probability of success went into calculating minimum, mean and maximum hydrocarbon volumes. These volumes along with economic considerations, such as wildcat costs and development costs went into determining which leases would be bid on by Shell.

14. After a successful bid on a lease, the lease was put into Offshore's drilling schedule on a priority basis consistent with other demands on the available money and equipment. A primary term on a lease was usually five years; so at least one well was drilled in that period of time. Since there will have been no prior production from the lease area, the first well drilled was referred as a "wildcat" well and was drilled for the purpose of determining if there was an economic quantity of hydrocarbons on the lease.

15. Wildcat wells are usually drilled from one of three types of equipment. If the well is to be drilled in 250 feet or less of water then what is referred to as a jack-up rig is used. That is, a watertight hull and platform with vertically adjustable legs is floated to the drill site; the legs are lowered until they rest on the seabed; and drilling operations are conducted from the platform. Most offshore wells are drilled with a jack-up type rig since most wells are drilled in less than 250 feet of water depth. The use of a jack-up rig could cost from $15,000 to $40,000 per day.

16. If the well is to be drilled in water between 250 and 3,000 feet deep then a semisubmersible rig is used for the drilling operations. A semisubmersible rig has a working deck similar to a jack-up rig, but it is stabilized by ballasting its pontoons and columns to a predetermined depth; anchor cables or thrusters keep the platform properly located for drilling. For wells drilled in

water in excess of 3,000 feet, a drill ship is the normal mode of drilling. The use of a drill ship could cost about $250,000 per day. The actual cost of drilling a well depends on the depth to which the well is to be drilled and the cost of the rig used. Thus the cost of a wildcat well ranges from $1 million for a 6000 foot test to $15 million for a 20,000 foot test in less than 250 feet of water. However, for a drill ship the costs could be ten times as high for equivalent depths below the sea floor.

17. If a wildcat well is successful there is often more seismic data gathered including velocity surveys. With the new data the reservoir structure is remapped. Although the seismic data acquired after the drilling of a successful wildcat well is gathered by the exploration department it is done after the well has been transferred from the exploration department to the production department both of which are in the Offshore Division of the E&P Organization. The gathering of seismic data is done by the exploration department because it has the necessary equipment and experience to do so.

PRODUCTION

18. After the potential rate of production and the potential recoverable reserves are determined, detailed engineering studies are conducted and plans are made toward the end of proposing a development program for the lease. If the program is adopted, Offshore enters into a contract to build a platform. The platform is fabricated and installed within a period of approximately six months if the property is in shallow water; a deep water project may take as long as two to three years. The average time to fabricate and install a platform is in a range of 12 to 18 months. A platform for the purpose for developing a lease may cost anywhere from $1.5 million for a platform to be used in ten feet of water to $12 million for a platform to be used in 285 feet of water and in the hundreds of millions of dollars for a platform to be used in 800 feet of water.

The OCS development procedures and costs are radically different from those practiced on land. For example, offshore operations may require that several wells that could be produced from be plugged and abandoned prior to finding the optimum placement for a platform from which the lease may be fully developed. On land there is no physical constraint that the property be developed from a relatively small area such as a platform; so wells may be drilled on 40 acre, 160 acre, or 640 acre spacing. The cost of drilling is also dramatically different. On land one might expect to encounter costs as follows:

Depth of Well	Cost
5,000 ft.	300,000-400,000
10,000 ft.	$750,000-1 million
15,000 ft.	$2 million

19. No production wells in the OCS are drilled to the installation of a platform; however, some of the exploration wells drilled in shallow water may be used for production as the property is developed. After the drill rig is installed on the platform the drilling operations begin. An 8 or 9 thousand foot well may take approximately 15 days to drill while a 17,000 foot well would take approximately 120 days. If the drilling is done in an oil field there will be production while other wells are being drilled. That is, after the first well is drilled production casing and the other equipment necessary for production will be installed, and production will start from that well. Thereafter a second well will be drilled and production equipment will be installed. Following the same pattern a third and fourth well will be drilled until the planned number of wells is completed. If the wells are being drilled in a gas field then for safety reasons all of the wells that are planned will be drilled and cased without production taking place during the

drilling activity. Then the other necessary equipment is put in place to bring the wells into production.

20. The equipment necessary to the operation of a production well includes separators, water treatment facilities, test facilities, compressors, and metering equipment. Because the fluids recovered from a well are often a complex mixture of oil, gas, and water, they must be separated into their components and treated to obtain a pipeline quality product. Several stages of separators may be used to separate the oil, gas, and the other components of the well fluid. The oil is treated sufficiently to obtain a quality acceptable to the pipeline operator servicing the platform. Similarly, the gas is treated until it is acceptable to the gas collection pipeline operator servicing the platform. Compressors are used to deliver the product to the pipeline at the proper pressure. The well fluids left after the separation of the gas and oil (mostly water) are run through water treatment facilities in the OCS until they meet the environmental standards required for their return to the sea.

The equipment necessary for the recovery of oil and gas offshore is substantially different from the equipment used onshore. The difference is such that downhole and well-head equipment is not interchangeable between onshore and offshore applications. There are also substantial differences between surface (above-ground) and platform equipment. The safety features and the size and configuration requirements imposed by operation on an offshore platform make it so difficult to use onshore equipment on a platform that such an occurrence would be extremely rare; and the added expense of equipment designed for offshore platform use precludes its use for onshore operations.

21. Test facilities are maintained in the OCS to ensure the quality of the crude oil delivered to the pipeline operator. And, of course, metering facilities are necessary to determine how much product is delivered to the pipeline operator. The pipeline servicing the platform may be owned by Shell or owned by an independent third party. Once the crude oil is in the pipeline it is transported to shore (continental United States) for delivery to a refinery or other manufacturing facility of either Shell or an unrelated refiner or manufacturer. The refined and manufactured products are marketed throughout the world. Most, but not all, of the crude oil extracted by Shell from the OCS wells was brought from the OCS to the continental United States. This crude oil was either refined in Shell's refineries in the continental United States, or was exchanged by Shell with other oil companies. The portion of that crude oil which was refined was either sold or exchanged. These exchanges were with other companies in the Petro-Chemical industry.

As is done with respect to crude oil, test facilities are maintained on the OCS to ensure the quality of a natural gas delivered to the pipeline operator, and metering equipment is used to measure the amount of natural gas transferred. All of Shell's OCS natural gas production is sold to pipeline companies at the producing platform on the OCS.

SHELL'S COMPUTATIONS

22. Attached hereto are copies of documents captioned "SHELL OIL COMPANY EXPLORATION & PRODUCTION SCHEDULE 'E'" for each of the years 1975-1980. They are marked as Exhibits 1, 2, 3, 4, 5, and 6 respectively. These documents are business records prepared in the normal course of Shell's business on an ongoing basis for various purposes and are computations of the equivalent of what Shell's net OCS income would be for federal income tax purposes if computed for that segment of Shell's business, according to Shell. The Schedules 'E' show the value of OCS production less related expenses (including the costs of negotiating the at-the-

platform sales of OCS production), computed in the manner described below. Shell offers these exhibits into evidence. The Department does not agree that these exhibits in any manner properly reflect Shell's net income from any source or segment of Shell's business and considers them to be irrelevant to any issue in this case and objects to Shell's offer on grounds of relevance only. (The brackets around the figures above line 14 in Exhibit 3 and above line 16 on Exhibit 4 do not denote negative income according to Shell. As one can see from looking at Exhibits 1-6, the manner in which the documents are prepared by Shell in the ordinary course of business is rather rough. For example, they are partially hand written. To aid in review a typewritten copy of each Schedule 'E' is attached to the handwritten copy.) None of Shell's refining and marketing activities occur on the OCS. None of Shell's refining and marketing expenses, or the amount of revenue from sales of refined petroleum or manufactured chemicals are included in the Schedules 'E'.

23. The following sub-paragraphs are explanations by Shell of the entries on the Schedules 'E'. The numbers of the sub-paragraphs correspond to the line numbers set on Schedule 'E' for the year 1975. The lines numbers, 01, 02, etc., may vary from year-to-year but the description of the terms set out on any line is the same for each of the years 1975-1980. The Department does not agree that such explanations and the numbers on Schedules 'E' show the net income, if any, that Shell derived from the OCS. After the following explanation of each of the Schedule 'E' entries, additional explanation of the Schedule 'E' documents is made in paragraph 24.

Line No. 01 Crude Oil & Lease Condensate

The entry on this line is determined by taking the volume of production, as metered (explained below), and

multiplying that volume by the current industry posted price for that grade of crude oil at the onshore delivery point less the transportation expense. For example, assume

crude oil to be delivered at—Gibson, Louisiana

Gibson posted price—$28.85/bbl

transportation expense (platform to Gibson)—$.35/bbl

then the price used to determine the platform value of the crude oil would be $28.50. The posted price is a written statement of crude oil prices circulated publicly among sellers and buyers of crude oil in a particular field and generally in all market areas (OCS and non-OCS) in accordance with historic practices, and generally known by sellers and buyers within the field. The posted price changes periodically depending on various market conditions. During the years at issue Shell's OCS crude oil prices were subject to price controls under the Emergency Petroleum Allocation Act of 1973, 15 U.S.C. §§ 751-760h. By historic practice and by statute, all sellers of crude oil must offer that crude oil at the posted price to all buyers without discrimination. The posted price is a price that must be paid to everyone from whom Shell purchases oil at a given location, and the price at which Shell would have to sell, if it sold oil from its wells. During the years in question there were some Shell sales of crude oil. However, Shell required amounts of crude oil in excess of all of its own production and purchased additional requirements from others. See paragraph 4, *supra*. A common occurrence of a Shell oil purchase on the OCS is the situation where Shell is engaged in a joint venture with other oil companies. Those companies may choose to sell their production to Shell rather than take it from the platform and attempt to transport it to a refinery.

The posted price less transportation expense was also used to compute the royalties to be paid to the federal government on oil well leases. The normal government royalty is 1/6 of the volume, determined as outlined below, times the applicable industry posted prices adjusted for gravity and transportation (adjusted posted price) for the time period involved. The proper accounting for the royalty payments is assured by the Mineral Management Service (MMS) which is a bureau of the Department of the Interior and falls under the authority of the Assistant Secretary of the Interior—Energy and Minerals. Within the MMS, the Associate Director for Royalty Management is responsible for the collection of royalties and for any audits of the royalty payments relating to Federal oil and gas leases. 30 U.S.C.A. § 201.100. For the years at issue Shell's royalty payments were audited by the MMS itself (1975 and 1976) and by the accounting firm of Alexander Grant on behalf of the MMS (1977-1980). The royalty payment is sometimes adjusted upward by the Mineral Management Service (MMS) of the Federal government which has the right to set the price and may or may not follow the adjusted posted price for royalty calculation. However, the royalty has never, to anyone's recollection, been adjusted downward; that is, Shell's value of production from the OCS for royalty computation purposes has always been found by the MMS or its agent to be at least the amount stated by Shell. A recently completed audit for the seven year period 1977-83 indicates maximum adjustment of less than .05% (five one-hundredths of one percent).

The prices used to compute the crude oil and lease condensate revenue on Line No. 01 of Shell's Schedule 'E' have always been those which would be paid to a third party if Shell were purchasing third party oil at the platform, i.e., the posted price less transportation expense. That is the ordinary and accepted industry practice used to value production. The purchase price of

crude oil and condensate is given to the E&P Accounting Department (which Department made the initial entries on the Schedule 'E's under the "Outer Continental Shelf" column) by the Raw Material Supply Department of Shell's Products Division which informs E&P Accounting of the price to be used.

The second element of the computation of the value of crude oil and condensate production on Shell's Schedule E was the volume. The volume was determined by metering and sampling. On the first of any month at 7:00 a.m., or as close thereto as possible, the metering devices at all transfer points were read to determine the volume transferred for the month. The meter is the custody transfer point and it is at that point that the quality of the crude was also required to be tested. The quality of the oil must be less than three percent BS and W (Basis Sediment and Water). If the posted price at transfer was in effect for the entire month, then the first of the month meter reading would be sufficient. If the posted price changed during the month then the meter would be read at the time the posted price changed, or as close to that time as possible. Generally that time frame would not vary by more than a few hours either side of the change in the posted price and no matter what time the reading was made that meter reading controlled in determining the amounts transferred at the posted prices.

The amounts shown on Line 01 of each of the Schedule E documents are equal to the appropriate volume measurements multiplied by the appropriate posted prices, as adjusted for gravity and transportation, for the crude oil and condensate produced by Shell on the OCS for each of the years in question. The amounts on line 01 which involve transfers of crude oil from the E&P Organization to the Products Organization do not involve actual transfer of cash payment. *See* paragraph 4, *supra*. The amounts shown on line 01 do not include crude oil actually purchased by Shell from other OCS producers.

Line No. 02 Natural Gas

All of the natural gas produced on the OCS (less that consumed in operations on the OCS) is purchased by gas transmission companies. The gas is measured by a "constant measuring device" which determines the volume of the flow of gas and the quality of the gas as it is transferred. The price of the gas is determined by contract in compliance with federal government regulation. All gas prices are regulated under the Natural Gas Policy Act or some similar act. Line 02 on each of the Schedule E's represents the dollar amount of cash revenue received by Shell for the natural gas produced on the OCS.

Royalty payments on natural gas are made to the Federal government under the same circumstances and subject to the same audit procedures that apply to OCS crude oil.

Line Nos, 03, 04, 05, 06 Gas Processing

Since the form for the Schedule 'E' is also used for areas other than the OCS (see paragraph 24, below) a format amenable to a range of activities is used. These lines accommodate the computation of income by Shell derived from gas processing operations. There was no gas processing revenue on the OCS because there were no gas processing plants located there. Gas processing is strictly an onshore operation.

Line No. 07 Less Own Gas to Plants

When natural gas is produced a portion of it contains impurities (water and excess hydrocarbon liquids). That portion is sent to onshore gas plants for processing. Such plants are owned either by Shell, by Shell and joint venturers, or are owned entirely by entities other than Shell. Regardless of the ownership of the gas plant, the processed gas (gas which has had impurities and hydrocarbon liquids removed) is delivered to a pipeline company at a contract price. The hydrocarbon liquids (products of processing the gas to contract specifications) are divided between the leaseholder and the plant (a common arrangement is 60% to the plant and 40% to the lease from which the gas was produced). The amount stated on Line 07 is the value of the liquid hydrocarbons attributable to the lease. The value of the hydrocarbon liquid is included in Line 02 as gas revenue because it is a value upon which the royalty must be computed. The value of those liquids is also included as revenue of the gas plant; so the OCS gas revenue (Line 02) must be reduced in order to avoid overstating total company revenue. Line 07 states revenue attributable to gas produced on the OCS.

Line No. 08 Prepaid Gas Sales

There were no prepaid gas sales of gas extracted by Shell on the OCS.

Line No. 09 Prepaid Water Sales

Revenue from water sales is attributable to wells that are drilled and hit water inadvertently or wells that are drilled for the purpose of finding water that may be used for secondary recovery operations. The revenue would be generated by sales of water to local water systems. There were no sales, prepaid or otherwise, of water located in the OCS.

Line No. 10 Other Production Department Revenue

This revenue is generated by the rental to pipeline companies of space on the platform. Such space is used by the pipeline companies to place compressors and metering facilities. The pipeline companies own the meters and they must have compressors to transfer the purchased product at pipeline pressure. The amount shown on this line on each of the Schedule E's is the amount of cash received by Shell for such rental.

Line No. 11 Other Gas Department Revenue

This revenue is attributable to the operation of some portions of pipeline. These portions of pipeline are the type operated by a gas producer in order to get gas to the trunk line that serves his area of the Gulf of Mexico. The revenue is generated by transmitting the other joint venturer's gas or by picking up gas from other platforms to be transported to the pipeline companies' main line. The business procedure is to purchase the gas from others who wish to transmit their production to the trunk pipeline and then to sell the gas down the pipeline at a higher price which reflects a transportation differential. For the years in question there was no such revenue.

Total Revenue

The amounts set out on the unnumbered line captioned "Total Revenue" on each of the Schedules 'E' for 1975-1980 are the total amounts that, according to Shell, Shell's OCS production would have yielded on the OCS market. According to Shell, a ready market existed for Shell's OCS production which market would not have been affected by Shell's sale of all of its crude oil. The revenue figures set out on the Schedule 'E' are the same revenue figures reported to the Mineral Management Service of the Federal Government and are subject to audit by the MMS. For 1975 and 1976 an audit was conducted by the MMS. For 1977 through 1980 (and for later years not here at issue) the stated revenue figures were audited for the MMS by the firm of Alexander Grant, an independent Public Accounting firm. After such audit, it was determined that the maximum change required for the total audit period is less than five one-hundredths of one percent (.05%) of the revenue involved. The amounts of the adjustments involved are presently at issue and those amounts are subject to being decreased but not increased. Thus the total revenue figures shown on this line of the Schedules 'E' for the

years at issue were accepted by the United States Government without any significant adjustment as the value of Shell's OCS production for those years upon which the Government's royalty for those years was based.

Line No. 12 Royalty—Crude And Condensate

The amount reflected is the 1/6 royalty paid to the federal government with respect to minerals extracted from the OCS all of which is under Federal government control. In strict theory this would be 1/6 of line 1 but differences do arise. The differences are attributable to prior period adjustments. That is, a royalty may have been overpaid or underpaid with respect to a prior period, so the amount is adjusted in the subsequent period.

Line No. 13 Royalty—Natural Gas

Same as line 12.

Line No. 14 Operating

This amount reflects the total payroll and burden (employment taxes, employee benefits), and cost of materials used in operating each OCS lease. These are all direct expenses.

Line No. 15 Well R&M And Reconditioning (Repair And Maintenance And Reconditioning)

This figure is made up of amounts for remedial work on the well. It also contains amounts spent for tubing, acid fracturing, wire line, and repairs to the wellhead and below the surface. An example of an expense item that would not fit here would be the cost of replacing the system of valves at the point where the well casing and tubing emerge from the drill hole. That item would be a capital item and any expense for it would appear under depreciation. *See* Line 29, *infra*.

Line No. 16 Production And Property Taxes and Insurance

There were no production, severance or property taxes on the OCS. In 1980 (see 1980 Schedule 'E' line 19) there is an entry for the Windfall Profit Tax which is a per barrel tax imposed by the United States Government on oil removed from a property after February 29, 1980. The number set out in line 16 is the cost of insurance, e.g., hazard insurance, and well restoration insurance for blowouts.

Line No. 17 Overhead

Direct operation, engineering and administrative support. The engineering and administrative support expenses include the OCS's prorated portion of such expenses incurred on behalf of the OCS by Shell personnel who do not work exclusively on OCS matters. The engineering and administrative personnel are located in New Orleans and Houston.

Line No. 18 Raw Material Purch. From Outside

During the years for which there are entries under this caption, Shell's Offshore Division participated in the operation of some onshore gas processing facilities. This amount reflects Shell's share of the cost of input gas purchased from other producers.

Line No. 19 Direct Plant

This amount is the direct cost of operating the gas processing facilities described in the preceding paragraph (Explanation of Line No. 18).

Line No. 20 Crude Handling

The costs of processing and handling crude oil on an OCS platform (to the extent any is done) is accounted for in the general operating costs of the platform and is included in Line 14, Operating. The cost of transferring

the crude oil through Shell's pipeline gathering system to a common carrier pipeline company is accounted for in the posted price less transportation expense which is recorded as payment for the crude oil. Shell owned the pipeline gathering system used to transport some of its crude oil from the platform to the common carrier pipe line company. A portion of Shell's OCS crude oil was moved to the common carrier pipeline through gathering systems owned by other companies, and any expense involved was reflected in the price paid for Shell's crude oil by the other company. Shell's gathering system was not used exclusively to carry Shell's production; crude oil purchased from others was also transported in the gathering system. Although the gathering system was located on the OCS, Shell did not account for the income or loss of that portion of its business as part of the OCS. The income or loss relating to that portion of Shell's business in any year was not significant according to Shell compared to total OCS or total Shell income.

Line No. 21 Miscellaneous Production Department Expense

These expenses are categorized as miscellaneous expenses because it is undesirable to include them in operating extraction costs. They are of such a nature as to be storm related, e.g., hurricane evacuation expenses; abnormal loss; and damage such as a building blowing up or being destroyed by fire. These are items that are beyond the control of the management charged with the responsibility for the profitability of a particular area. Accordingly, Shell does not include these expenses in the category of expenses by means of which management performance is evaluated. These are direct expenses attributable to a particular well.

Line No. 22 Miscellaneous Gas Department Expense

There are no such expenses on the OCS because there is no gas processing on the OCS.

Operating Cash Income

This figure is the net of the stated Total Revenue (see explanation, *supra*, between Lines No. 11 and Line No. 12) and the expenses set out on Lines No. 12 through 22. This does not represent an actual payment of cash from Shell's Products Organization to Shell's E&P Organization.

Line No. 23 Exploration Expense

These expenses include such things as the cost of operation of a seismic vessel, and the expense of having geologists read and analyze the seismic record. This expense includes an OCS prorated portion of exploration expenses incurred by Shell personnel not working exclusively on OCS matters.

Line No. 24 Land Expense

This expense includes the cost of surveys and the preparation of the bids filings necessary for lease sales. This expense includes an OCS prorated portion of land expenses incurred by Shell personnel not working exclusively on OCS matters.

Line No. 25 Lease Rental Expense

This is a payment by Shell to the Federal government for the purpose of keeping each OCS lease in effect prior to its development.

Line No. 26 Research

This involves research and technical experiments involving new techniques in exploration and production. This is the OCS's prorated portion of Shell's research expenses.

Line No. 27 HO (Head Office) Miscellaneous

OCS prorated portion of miscellaneous corporate expense. This included such items as executive compensa-

tion, contributions to the Shell Company Foundation, operation of company aircraft and state franchise taxes.

Line No. 28 Depletion

This is the amount allowable under federal income tax law as a deduction for depletion on Shell's OCS properties.

Line No. 29 Depreciation

This is the amount allowable as a deduction under federal income tax law for depreciation of Shell's OCS assets. This is the OCS's prorated portion of Shell's depreciation expense.

Line No. 30 Intangible Amortization

This amount is the amortization of capitalized intangible drilling costs. For federal income tax purposes a taxpayer is allowed to deduct in the year incurred certain expenses related to the drilling of, and the installation of certain equipment in, an oil or gas well. These amounts are commonly referred to as intangible drilling costs or IDCs. Accounting principles require that such amounts be capitalized and recovered over the life of the well as oil or gas is produced. Accordingly the 'book' amount will be -0- and the 'Federal Basis' amount will be that amount of IDC incurred in OCS operations. [Compare Line No. 30 with the Line captioned "Intangible Development Costs per Tax."]

Line No. 31 Exploration Dry Holes

These are the costs of wildcat wells described in the narrative description of the OCS operations under exploration. The cost reflected is the direct cost of drilling the hole during some of the years in question. These amounts were treated as immediate expenses.

Line No. 32 Reversal

In the years 1975-1977, the costs of Exploration Dry Holes [Line No. 31] were expensed as incurred, but if the well proved productive the prior expenses were reversed and put into a capital account. For 1978 and later years the accounting practice was to expense the cost of Exploration Dry Holes only after determining that such a well would not be productive. Thus there is no Reversal for 1978-80.

Line No. 34 Amortization

This reflects amortization of Shell's non-producing OCS leases.

Line No. 35 Surrender

This amount reflects losses allowable under the federal tax law for the surrender of OCS leases. These amounts are attributable to leases from which there was no production.

Line No. 36 Abandonments And Retirements

This amount reflects losses allowable under the Federal tax law for the abandonment of leases and/or retirement of equipment used on a lease. These amounts are attributable to leases from which there was production.

Line No. 39 PDET Dry Holes [Production Department Exploratory Test]

This is the cost of wells drilled for the purpose of determining the boundaries of the reservoir.

Line No. 40 Net Income Before F.I.T.

This is Shell's computation of Shell's taxable income for the OCS segment of Shell's business computed, according to Shell, pursuant to Federal income tax laws

and regulations as if its entire business had been limited only to OCS activities. The Department does not agree that Line No. 40 constitutes a computation pursuant to Federal income tax laws and regulations. Shell has made the same computations as are on the Schedule 'E' Exhibits with respect to some of its non-OCS production, e.g., computation of income for state tax purposes in Mississippi and Oklahoma.

24. The Schedule 'E' is a document prepared in the normal course of Shell's business by the E&P Accounting Office and the Federal Income Tax Department of Shell Oil Company for use by Shell's State Income Tax Department. During the years at issue Schedules 'E' were prepared for Mississippi, Oklahoma, and the OCS as well as several other areas. The entries made on the Schedule E consist of dollar amounts entered under the columns captioned "Schedule 'M' ", "Outer Continental Shelf", and "Federal Basis" (or "Tax Basis"). The Schedule 'E' amounts are used to calculate royalties paid to the Federal government on OCS leases and are used in the calculation of the OCS depletion deduction on Shell's income tax returns. Similar Schedules 'E' are used also to calculate depletion deductions for non-OCS areas which are included on Shell's income tax returns.

The Schedules 'E' attached only apply to the OCS and therefore do not purport to show the entire amount of Shell's federal or state taxable income for any taxable year. Although Shell contends that the Schedules 'E' show the equivalent of net OCS income for Federal income tax purposes for each year involved, Shell does not, for Federal income tax purposes, compute a federal taxable income solely for the OCS, nor is Shell required to do so.

The initial entries made on the Schedules 'E' are entered under the column captioned "Outer Continental Shelf". They are taken from what is known as the E&P

Black Book, document prepared by the E&P Accounting Office for the purposes of:

a) Providing an internal management tool for the determination of the effectiveness of the management personnel of a given segment of Shell's business;

b) Determining segment income for Shell's purposes for publication in Shell's annual reports;

c) The preparation of state income tax returns for Oklahoma and Mississippi. Shell is required by those two states to compute a "net income" attributable to these two states pursuant to the state's requirement that a computed "production income" be allocated.

The dollar amounts computed by Shell and entered on the Schedule 'E' under the "Outer Continental Shelf" column are "book" numbers, that is, the amounts entered in that column represent Shell's computed amounts of income and expense without making any adjustments which are required to be made for a particular entry for tax purposes when preparing and filing Shell's federal income tax return. The "Federal Basis" column of the Schedule 'E' represents the OCS "tax" numbers for each entry, after adjustments have been made by Shell when preparing and filing Shells' Federal income tax return. The Schedule 'M' column of the Schedule 'E' documents reflects Shell's computed difference, if any, between the "Outer Continental Shelf" columns and the "Federal Basis" columns for a particular entry. Thus, the amounts shown on line 40 under the "Federal Basis" column of the 1975 Schedule 'E' and on comparable lines for 1976-80, are, according to Shell, the equivalent of net income before Federal income tax of Shell's OCS operations determined as if the OCS Federal taxable income was computed for that segment of Shell's business for

each of those years. The Department does not agree that such computations are the equivalent of Shell's net OCS income for Federal income tax purposes as alleged by Shell. See paragraph 22, *supra*.

25. Attached hereto and marked Exhibit 7 are computations by Shell of Shell's Iowa income tax assuming: (1) Shell's total value of production (Revenue), as computed by Shell, from the OCS was excluded from Shell's Iowa pre-appointment net income base (Exhibit 7, pages 1-6), and (2) only "net OCS income" as computed by Shell and shown on the Schedules 'E' for each year in question was excluded from Shell's pre-apportionment net income base (Exhibit 7, pages 7-12). Exhibit 8 attached hereto shows Shell's computed Everywhere Gross Receipts and Shell's computed OCS Total Value of Production for 1975-80. The Department does not agree that Shell's computations on Exhibit 7 represent "net income" or "revenue" from the OCS and does not agree that Exhibit 8's computed OCS "total value of production" can be used by Shell for any Iowa income tax purpose.

Shell claims that the amount of "Total Revenue" set forth on the unnumbered line after Line 11 on the Schedules 'E', and shown on Exhibit 8 as "OCS Value Of Production" for each of the years in question should be excluded from Shell's Iowa pre-apportionment net income for purposes of computing Shell's Iowa income tax liability for each of said years by reason of the provisions of the OCS Lands Act, 43 U.S.C. § 1333(a)(2)(A) and (a)(3). If that was done the amount excludable from Shell's Iowa pre-apportionment net income for each year in question and the amount of refund due taxpayer as computed per Exhibit 7, pages 1-6, for each year in question would be as follows:

Year	Total OCS Value of Production Per Schedule 'E'	Amount of Refund Due Taxpayer per Exhibit 7, pp. 1-6
1975	484,829,200	127,850
1976	526,193,100	70,051
1977	625,009,500	266,432
1978	727,485,804	358,624*
1979	875,965,196	550,496
1980	1,379,129,782	504,750*

Shell has not filed a claim for refund with the Department of Revenue for any of the above years.

In the alternative, Shell claims that by reason of the same statutory provisions the amounts shown on Line 40 under the "Federal Basis" column of the 1975 Schedule 'E' and on the comparable lines for 1976-80 should be deducted for each year involved from Shell's Iowa pre-apportionment net income for Iowa income tax purposes if Shell prevails on the OCS issue. If that was done the amount excludable from Shell's Iowa pre-apportionment income for each year in question and the amount of tax in dispute, as shown on Exhibit 7, pages 7-12, for each year in question would be as follows:

Year	OCS Income Computation Per Schedule 'E'	Amount of Tax in Dispute Per Exhibit 7, pp. 7-12
1975	$ 92,233,400	$41,370
1976	150,652,400	62,511
1977	71,086,000	23,460
1978	1,126,396	(8,612)
1979	195,351,771	71,589
1980	316,235,922	85,839

With respect to tax years 1975-77, Shell is also claiming that no additional tax is due at all because the Department of Revenue assessment for those years is

* Amount of refund claimed is limited by the amount of credits and payments set out on line 12 of Exhibit 7.

barred by the statute of limitations. See III hereof, *infra*, and Protest filed herein. Therefore, the above amounts of disputed tax for 1975-1977 would only be applicable for those years if Shell does not prevail on its statute of limitation argument for those years.

The unnumbered line captioned "Total Revenue" set out on each of the Schedules 'E' is Shell's computation of total revenue associated with Shell's OCS production for each of the years 1975-80 as depicted by the sum total of lines 01 through 11. It does not, however, take into account Shell's sales of products refined from OCS production. Shell's refining and manufacturing processes applied to OCS—produced minerals always occur in non-OCS areas in the continental United States.

Shell files tax returns with every state (45 states and the District of Columbia) that has an income tax or a franchise tax measured by income. With the exception of Mississippi, Oklahoma, Alaska (for 1978-81), Iowa (for 1977-80) and Florida, Shell apportioned its net income to all other states (without deduction of its separately-computed OCS net income, all as computed by Shell pursuant to the procedures in Exhibit 7) on the basis of a three-factor formula. Shell, in filing state income tax returns, has never excluded its total OCS value of production from the pre-apportionment net income base pursuant to the procedures in Exhibit 7. Shell's factors for use in the three-factor formula in the years at issue are set out in Exhibit 9, attached hereto. Had Shell deducted its separately-computed OCS net income in the just-stated computation, Shell would have paid less tax in each of those states in each of the years at issue with the exception of 1978. [In 1978 the effect of the reduction of apportionable income by the amount of OCS net income would not have offset the increase in apportionable income caused by the increase in the apportionment formula percentage due to the removal of OCS property, payroll and sales from the apportionment factors.] Had Shell deducted its total OCS

value of production it would have paid less tax in every year.

Attached hereto and marked Exhibit 10 is a copy of the Department's Notice of Assessment relating to these proceedings which is dated June 10, 1982. Shell offers Exhibits 7, 8, 9, and 10; the Department objects to Exhibits 7 and 8 on the grounds of relevancy.

* * * * *

[Deleted material pertaining to state statute-of-limitations issue]

IV

THE ISSUES

43. Whether the Department of Revenue notice of assessment of June 10, 1982 (Exhibit 10), would result in the taxation of any revenues or any of the net income derived by Shell from the OCS and, if so, whether that is in violation of the Outer Continental Shelf Lands Act (43 U.S.C. § 1331 *et seq.*), and/or the Supremacy Clause of the United States Constitution (U.S. Const. Art. VI, cl. 2), and the case law applicable thereto.

* * * * *

[Deleted material pertaining to state statute-of-limitations issue]

V

RELIEF REQUESTED

47. Shell requests the following relief:

a. Elimination of the amounts assessed for 1975-1977; and

b. A declaration that the taxation of Shell's OCS revenues and/or OCS income is in violation of the Outer Continental Shelf Lands Act and the Supremacy Clause of the United States Constitution; and

c. Elimination of OCS total revenues as shown after Line 11 on Exhibits 1, 2, 3, 4, 5, and 6 (the same amounts are shown as OCS Value of Production on Exhibit 8), for each of the tax years in question from Shell's preapportionment income base and an adjustment of Shell's Iowa corporate income tax consistent therewith in the amounts shown on Exhibit 7, pages 1-6.

d. In the alternative, an elimination of the OCS net income as shown on Line 40 under the "Federal Basis" column of Exhibit 1 and the comparable lines of Exhibits 2, 3, 4, 5 and 6 (the same amounts are shown on line 1, under the "OCS" column of Exhibit 7, pages 7-12) for each of the tax years in question from the preapportionment net income base and an adjustment to Shell's Iowa corporate income tax consistent therewith in the amounts shown on Exhibit 7, pages 7-12.

48. The Department of Revenue requests the following relief:

That the Department of Revenue's assessment in the form attached hereto as Exhibit 10, be upheld in its entirety together with interest which accrues according to law. That Shell's refund claim, if it is entitled to make one, be held to be untimely.

VI

ADDITIONAL EXHIBITS

49. In addition to Exhibits 1 through 10 attached hereto, it is agreed that the Forms 10-K of Shell for the years 1975-80 to be submitted to the Hearing Officer with this Stipulation shall be admitted into evidence as Exhibits A, B, C, D, E, and F, respectively. The Iowa income tax returns of Shell for the years 1975-80 shall also be admitted into evidence as Exhibits G, H, I, J, K, and L, respectively, and submitted to the Hearing Officer with this Stipulation. It is also agreed that a certain letter dated September 10, 1980, written by Lloyd Kennedy, corporate attorney of Shell, is offered into evidence as Exhibit M by the Department of Revenue. Shell objects to the admission of said letter into evidence on

the ground of relevancy and on the further ground that said letter was written as a part of proposed settlement negotiations in a prior dispute of a similar nature and is therefore inadmissible into evidence in this case. The Department does not agree that the letter, Exhibit M, was written as a part of any settlement negotiations. It was the Department's understanding that Exhibit M set forth Shell's position at the time with reference to the OCS and was an argument as to why the Department should adhere to that position. In addition, the Department contends that an objection based on settlement negotiations is not grounds for exclusion of evidence under Iowa Code § 17A.14 (1983) and Department Rule 730 I.A.C. § 7.17(2).

* * * * *

[Deleted material pertaining to briefing schedule]

Dated December 11, 1984.

Iowa Department of Revenue

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Its Attorneys

EXHIBIT 7
SHELL OIL COMPANY
IOWA INCOME TAX
1975
[Page 7]

Description (From Audit Schedule)	As Audited	OCS	Net
1. Income Per Consolidating Income Statement	780,559,118	92,233,400	688,325,718
2. b d & e	(1,607,177)	—	(1,607,177)
2. f 50% Federal Tax	780,559,118	92,233,400	688,325,718
Numerator	818,271,268	—	818,271,825
Denominator	294,164,082		294,164,082
Multiplier	(140,303,324)	(16,578,793)	(123,724,531)
Results at 50%	638,648,617	75,654,607	562,994,010
3. Income After Adjustments	43,083,811	—	43,083,811
4. Less: Total Net Allocable Nonbusiness Income	595,564,806	75,654,607	519,910,199
5. Net Income Subject to Apportionment	57,210,710	—	57,210,710
6. Business Activity Ratio:	9,855,825,457	82,278,684	9,773,546,773
Numerator	.5805%	—	.5854%
Denominator	3,457,254		3,043,554
Percent to Iowa			
7. Net Income Apportioned to Iowa	1,205		1,205
8. Add: Net Nonbusiness Income Allocated to Iowa	3,458,459		3,044,759
10. Net Income Subject to Iowa Tax	343,346		301,976
1. Computed Tax	200,000		200,000
2. Less Credits and Payments	143,346		101,976
3. Additional Tax (Over Assessment)			

EXHIBIT 7
SHELL OIL COMPANY
IOWA INCOME TAX
1976
[Page 8]

Description (From Audit Schedule)	As Audited	OCS	Net
1. Income Per Consolidating Income Statement	1,066,604,514	150,652,400	915,952,114
2. b d & e	(6,476,406)	—	(6,476,406)
2. f 50% Federal Tax			
Numerator	1,066,604,514	150,652,400	915,952,114
Denominator	1,124,395,749		1,124,395,749
Multiplier	468,870,631		468,870,631
Results at 50%	(222,385,809)	(31,410,815)	(190,974,994)
3. Income After Adjustments	837,742,299	119,241,585	718,500,714
4. Less: Total Net Allocable Nonbusiness Income	38,411,912	—	38,411,912
5. Net Income Subject to Apportionment	799,330,387	119,241,585	680,088,802
6. Business Activity Ratio:			
Numerator	62,846,606	—	62,846,606
Denominator	11,231,319,792	123,615,000	11,107,704,792
Percent to Iowa	.5596%	—	.5658%
7. Net Income Apportioned to Iowa	4,473,053		3,847,942
8. Add: Net Nonbusiness Income Allocated to Iowa	1,357		1,357
10. Net Income Subject to Iowa Tax	4,474,410		3,849,299
1. Computed Tax	444,941		382,430
2. Less Credits and Payments	240,000		240,000
3. Additional Tax (Over Assessment)	204,941		142,430

EXHIBIT 7
SHELL OIL COMPANY
IOWA INCOME TAX
1977
[Page 9]

Description (From Audit Schedule)	As Audited	OCS	Net
1. Income Per Consolidating Income Statement	876,498,358	71,086,000	805,412,358
2. a b c d & e	6,899,783	—	6,899,783
2. f 50% Federal Tax			
Numerator	884,252,856	71,086,000	813,166,856
Denominator	950,521,061	—	6,899,783
Multiplier	311,648,636		311,648,636
Results at 50%	(144,960,595)	(11,653,514)	(133,307,081)
3. & 5. Income After Adjustments and Net Income Subject to Apportionment	738,437,546	59,432,486	679,005,060
6. Business Activity Ratio:			
Numerator	65,009,337	—	65,009,337
Denominator	12,828,966,328	242,567,085	12,586,399,243
Percent to Iowa	.5067%	—	.5165%
7. & 10. Net Income Apportioned to Iowa and Net Income Subject to Iowa Tax	3,741,663		3,506,061
1. Computed Tax	371,666		348,206
2. Less Credits and Payments	328,537		328,537
3. Additional Tax (Over Assessment)	43,129		19,669

EXHIBIT 7
SHELL OIL COMPANY
IOWA INCOME TAX
1978
[Page 10]

Description (From Audit Schedule)	As Audited	OCS	Net
1. Income Per Consolidating Income Statement	703,647,701	1,126,396	702,521,305
2. a b c d & e	541,518	—	541,518
2. f 50% Federal Tax			
Numerator	703,647,701	1,126,396	702,521,305
Denominator	769,820,019	—	769,820,019
Multiplier	205,081,954		205,081,954
Results at 50%	(93,726,743)	(150,001)	(93,576,742)
3. & 5. Income After Adjustments and Net Income Subject to Apportionment	610,462,476	976,395	609,486,081
6. Business Activity Ratio:			
Numerator	83,309,117	—	83,309,117
Denominator	13,749,636,905	334,637,691	13,414,999,214
Percent to Iowa	.6059%	—	.6210%
7. & 10. Net Income Apportioned to Iowa and Net Income Subject to Iowa Tax	3,698,792		3,784,909
1. Computed Tax	367,379		375,909
2. Less Credits and Payments	358,624		358,624
3. Additional Tax (Over Assessment)	8,755		17,367

EXHIBIT 7
SHELL OIL COMPANY
IOWA INCOME TAX
1979
[Page 11]

Description (From Audit Schedule)	As Audited	OCS	Net
1. Income Per Consolidating Income Statement	1,309,966,780	195,351,772	1,114,615,008
2. a b c & g	841,799	—	841,799
2. f 50% Federal Tax			
Numerator	1,309,966,780	195,351,772	1,114,615,008
Denominator	1,391,555,550		1,391,555,550
Multiplier	498,738,174		498,738,174
Results at 50%	(234,748,243)	(35,007,345)	(199,740,898)
3. & 5. Income After Adjustments and Net Income Subject to Apportionments	1,076,060,336	160,344,426	915,715,910
6. Business Activity Ratio:			
Numerator	95,272,787	—	95,272,787
Denominator	18,358,435,310	439,985,470	17,918,449,840
Percent to Iowa	.5190%	—	.5317%
7. & 10. Net Income Apportioned to Iowa and Net Income Subject to Iowa Tax	5,584,753		4,868,861
1. Computed Tax	555,975		484,386
2. Less: Credits and Payments	673,000		673,000
3. Additional Tax (Over Assessment)	(117,025)		(188,614)

EXHIBIT 7
SHELL OIL COMPANY
IOWA INCOME TAX
1980
[Page 12]

Description (From Audit Schedule)	As Audited	OCS	Net
1. Income Per Consolidating Income Statement	1,584,428,478	316,235,922	1,268,192,556
2. a b c d & e	486,613	—	486,613
2. f 50% Federal Tax			
Numerator	1,584,428,478	316,235,922	1,268,192,556
Denominator	1,748,548,628	—	1,748,548,628
Multiplier	597,877,017		597,877,017
Results at 50%	(270,879,841)	(54,064,823)	(216,815,018)
3. & 5. Income After Adjustments and Net Income Subject to Apportionment	1,314,035,250	262,171,099	1,051,864,151
6. Business Activity Ratio:			
Numerator	100,144,891	—	100,144,891
Denominator	28,169,323,147	541,190,566	27,628,132,581
Percent to Iowa	.3555%	—	.3625%
7. & 10. Net Income Apportioned to Iowa and Net Income Subject to Iowa Tax	4,671,395		3,813,008
1. Computed Tax	464,640		378,801
2. Less Credits and Payments	504,750		504,750
3. Additional Tax (Over Assessment)	(40,110)		(125,949)

BEFORE THE
IOWA STATE DEPARTMENT OF REVENUE
HOOVER STATE OFFICE BUILDING
DES MOINES, IOWA

Docket No. 82-157-2A-A

IN THE MATTER OF SHELL OIL COMPANY
One Shell Plaza, P. O. Box 2463, Houston, TX 77001

CORPORATE INCOME TAX ASSESSMENT

AFFIDAVIT OF STEVEN C. STRYKER

[Dated December 17, 1984]

STATE OF TEXAS)
) ss:
COUNTY OF HARRIS)

STEVEN C. STRYKER, of full age, being duly sworn according to law, upon his oath deposes and says:

1. My name is Steven C. Stryker. I am employed in the Tax Department of Shell Oil Company (Shell). As General Manager and Assistant General Tax Counsel, I have as part of my overall responsibility the responsibility for the filing of the Federal Consolidated Income Tax Return, and from August, 1981 to June 30, 1984, I also had the responsibility for the filing of the State Income and Franchise Tax Returns in all states where Shell is required to file those returns.

2. I make this Affidavit in support of Shell's protest in the above-captioned matter. The information hereinafter recited is within my personal knowledge and has

been acquired by me during the course and within the scope of my employment with Shell.

* * * *

13. The computations set forth in Exhibit 7 attached to the Stipulation are true, correct and accurate computations of what the Iowa income tax liability of Shell would have been for each of the years 1975-80 assuming:

(1) Shell's total value of production (revenue) from the OCS as shown after line 11 of the Schedules 'E' was excluded from Shell's Iowa pre-apportionment net income base (Exhibit 7, pages 1-6), or

(2) Only Shell's net OCS income as shown on line 40 of Exhibit 1 or comparable lines of Exhibits 2, 3, 4, 5 and 6 for each year in question was excluded from Shell's pre-apportionment net income base (Exhibit 7, pages 7-12).

* * * * *

/s/ Steven C. Stryker
STEVEN C. STRYKER
General Manager and
Assistant General Tax Counsel

Subscribed and Sworn to before me this 17th day of December 1984.

/s/ [Illegible]
Notary Public in and for
the State of Texas

My commission expires 3/18/86

SUPREME COURT OF THE UNITED STATES

No. 87-984

SHELL OIL COMPANY,
Appellant
v.
IOWA DEPARTMENT OF REVENUE

APPEAL FROM THE SUPREME COURT OF IOWA

February 22, 1988

The statement of jurisdiction in this case having been submitted and considered by the Court, in this case probable jurisdiction is noted.

Supreme Court, U.S.
FILED
APR 21 1988
JOSEPH F. SPANIOL, JR.
CLERK

No. 87-984

In the Supreme Court of the United States

OCTOBER TERM, 1987

SHELL OIL COMPANY, APPELLANT

v.

THE IOWA DEPARTMENT OF REVENUE, APPELLEE

On Appeal from the Supreme Court of Iowa

BRIEF FOR THE APPELLANT

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QUESTION PRESENTED

Whether the Outer Continental Shelf Lands Act, 43 U.S.C. §§ 1331 *et seq.*, prohibits states from taxing income earned from the extraction of oil and gas from the outer Continental Shelf.

PARTIES TO THE PROCEEDING AND RULE 28.1 STATEMENT

All of the parties to the appeal of Shell Oil Company in the Supreme Court of Iowa are listed in the caption to this brief. Kelly-Springfield Tire Co. was a party to a separate appeal that was consolidated with the Shell appeal in the Iowa Supreme Court because of an issue, entirely unrelated to the question presented in this Court, that was common to the two appeals below.

Shell Oil Company's parent companies, subsidiaries (excluding wholly-owned subsidiaries), and affiliates are listed at J.S. App. 97a-103a.

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In the Supreme Court of the United States

OCTOBER TERM, 1987

No. 87-984

SHELL OIL COMPANY, APPELLANT

v.

THE IOWA DEPARTMENT OF REVENUE, APPELLEE

On Appeal from the Supreme Court of Iowa

BRIEF FOR THE APPELLANT

OPINIONS BELOW

The opinion of the Supreme Court of Iowa (J.S. App. 1a-14a) is reported at 414 N.W.2d 113. The opinion of the District Court of Polk County (J.S. App. 15a-35a) is not reported.

JURISDICTION

The judgment of the Supreme Court of Iowa was entered on October 21, 1987 (J.S. App. 1a). A notice of appeal to this Court (J.S. App. 92a-93a) was filed on November 23, 1987. The appeal was docketed on December 15, 1987, and the Court noted probable jurisdiction on February 22, 1988 (J.A. 59). The jurisdiction of the Court over this appeal rests on 28 U.S.C. § 1257(2).

CONSTITUTIONAL AND STATUTORY PROVISIONS INVOLVED

The issue in this case is whether the Iowa corporate income tax code, as applied to appellant Shell Oil Company, is invalid under the Supremacy Clause of the United States Constitution (Art. VI, cl. 2) to the extent that it conflicts with the provisions of the Outer Continental Shelf Lands Act ("OCSLA"), 43 U.S.C. §§ 1331 *et seq.* The relevant provisions of the OCSLA and the Iowa corporate income tax code are set forth at J.S. App. 94a-96a.

STATEMENT

This case presents the question whether the Outer Continental Shelf Lands Act ("OCSLA"), 43 U.S.C. §§ 1331 *et seq.*, prohibits states from taxing income earned from the extraction of oil and gas on the outer Continental Shelf ("OCS") pursuant to federal lease.[1] Contrary to the decision below, such taxation is invalid under the OCSLA and the Supremacy Clause because it is inconsistent with the exclusive jurisdiction of the federal government over the OCS, with the explicit language of the OCSLA that state taxation laws "shall not apply" to the OCS, and with the congressional policy of prohibiting state taxes of OCS production in order to enhance the federal government's revenues from lease payments and to promote development of the OCS.

[1] The term "income earned" refers to the portion of income from the sale of OCS oil and gas that is attributable to the extraction of the resource on the OCS. In other words, it is the increment of income that represents the net value at the wellhead (*i.e.*, fair market value less related costs and expenses) of the OCS production. See note 3, *infra*. See also *Atlantic Richfield Co.* v. *Alaska*, 705 P.2d 418 (Alaska 1985), appeal dismissed, 474 U.S. 1043 (1986) (Burger, C.J., and White and Stevens, JJ., dissenting):

> Obviously, profits do not result from * * * oil production until the product is sold. This does not negate the fact that profits generated by the sale are partly attributable to the inherent value of the * * * oil at its point of production.

705 P.2d at 425.

A. The Outer Continental Shelf Lands Act

The outer Continental Shelf is defined as all submerged lands appertaining to the United States that are outside the area three geographical miles (three marine leagues in the case of Florida and Texas) from the coast line of the United States. See 43 U.S.C. §§ 1331(a) and 1301(a)(2). The OCS lies off the shores of the continental United States, Alaska, and Hawaii, and is not located within any of the 50 states. J.S. App. 18a-19a.

Beginning in the 1930s, a dispute developed between the federal government and the states over off-shore lands (both inside and outside the three-mile limit) and the natural resources they contain. In a series of decisions, this Court held that the states were "not the owner of the three-mile marginal belt along [the] coast, and that the Federal Government rather than [a] state has paramount rights in and power over that belt, an incident to which is full dominion over the resources of the soil under that water area, including oil." *United States* v. *California*, 332 U.S. 19, 38-39 (1947); see also *United States* v. *Louisiana*, 339 U.S. 699, 705 (1950) ("[i]f, as we held in California's case, the three-mile belt is in the domain of the Nation rather than that of the separate States, it follows *a fortiori* that

the ocean beyond that limit also is"); *United States* v. *Texas*, 339 U.S. 707 (1950).

In response to these rulings recognizing the paramount rights of the United States in such off-shore areas, Congress in 1953 enacted two statutes. First, in the Submerged Lands Act, 43 U.S.C. §§ 1301-1315, Congress relinquished to the states title to and ownership of the submerged lands and natural resources within the three-mile limit. By that Act "the United States, in effect, quitclaimed to [the states] whatever interest the Federal Government may have had in, and to, all lands and natural resources lying within three geographical miles seaward of the * * * coastline." *United States* v. *California*, 447 U.S. 1, 3 (1980); see also *Secretary of Interior* v. *California*, 464 U.S. 312, 315-316 (1984); *United States* v. *Louisiana*, 363 U.S. 1, 6-7 (1960).

Second, Congress adopted the Outer Continental Shelf Lands Act, 43 U.S.C. §§ 1331-1356. See *Gulf Offshore Co.* v. *Mobil Oil Corp.*, 453 U.S. 473, 479-480 n.7 (1981). The OCSLA declares that the outer Continental Shelf is "subject to [the] jurisdiction [and] control [of the United States]" (43 U.S.C. § 1332(1)) and is "an area of exclusive Federal jurisdiction" (43 U.S.C. § 1333(a)(1)). Accordingly, the "Constitution and laws" of the United States were extended to the OCS (*ibid.*). Moreover, "to fill the substantial 'gaps' in the coverage of federal law, OCSLA borrows the 'applicable and not inconsistent' laws of the adjacent States as surrogate federal law." *Gulf Offshore*, 453 U.S. at 480; see 43 U.S.C. § 1333(a)(2)(A); *Rodrigue* v. *Aetna Casualty & Surety Co.*, 395 U.S. 352, 356-359 (1969). This Court has recognized that the OCSLA

establishes "the exclusive jurisdiction and control of the Federal Government" over the OCS (*Gulf Offshore*, 453 U.S. at 479 n.7).

In addition to providing that the OCS is an area of exclusive federal jurisdiction, the OCSLA specifically addresses the issue of state taxation. Section 1333(a)(2)(A) provides that "State taxation laws shall not apply to the outer Continental Shelf." This prohibition is reinforced by Section 1333(a)(3), which directs that the OCSLA "shall never be interpreted as a basis" for a state to claim "any interest in or jurisdiction * * * over the seabed and subsoil of the outer Continental Shelf, or the property and natural resources thereof or the revenues therefrom."

The OCSLA recognizes that "the outer Continental Shelf is a vital national resource reserve" that "should be made available for expeditious and orderly development" (43 U.S.C. § 1332(3)). In furtherance of that policy, the federal government has established a system of competitive bidding to lease OCS lands for the exploration, development, and production of crude oil, natural gas, and other minerals. See 43 U.S.C. §§ 1334, 1337. Although the Act authorizes several alternatives, a lessee generally pays the government a cash bonus when its bid is accepted, a fixed delay rental during the period prior to production, and a production royalty that is normally one-sixth of the value of production as measured by the volume of production times the industry posted price at the wellhead. See *Watt* v. *Energy Action Educational Foundation*, 454 U.S. 151, 153-154 (1981); J.S. App. 19a. Between 1954 and 1985, the federal government received some $52.7 billion in OCS lease bonus payments, $28.1 billion in royal-

ties, and $0.7 billion in other revenues. U.S. Dep't of the Interior, *Federal Offshore Statistics: 1985*, Tables 2 & 16.

B. Shell's OCS Oil And Gas Activities

Appellant Shell Oil Company is a Delaware corporation with business operations in all 50 states and the District of Columbia. Shell is engaged in the exploration for, and the development, production, transportation, purchasing, and marketing of, crude oil and natural gas, and in the purchase, manufacture, and marketing of oil and chemical products. J.S. App. 16a.[2]

Pursuant to leases obtained from the federal government through competitive bidding, Shell explores for and extracts crude oil and natural gas on the OCS. During the past decade, Shell has paid the government more than $2.2 billion in cash bonuses on Gulf of Mexico and Atlantic federal off-shore leases, $18 million in pre-production rentals, and $2.4 billion in royalties.

Shell controls the disposition of the crude oil and natural gas that it extracts from the OCS. Shell sells all of its gas production to third parties on the Shelf. See *Maryland* v. *Louisiana*, 451 U.S. 725, 730, 731 (1981) (most OCS gas is sold at the wellhead). In contrast, while Shell sells a small portion of its OCS oil on the Shelf, most of its oil production

[2] The factual record in this case was stipulated by the parties, and the facts recited in the lower courts' opinions are based on that stipulation. The relevant portions of the stipulation are reprinted at J.A. 13-50. The facts summarized in this brief relate to calendar years 1975-1980, the tax years in dispute below.

is transferred internally between divisions of Shell on the OCS and is then brought to the mainland, where it is either sold to third parties or refined by Shell for subsequent sale. J.S. App. 17a, 20a; J.A. 31, 34.

The oil and gas extracted from the OCS has a determinable fair market value at the wellhead. The market value of the gas is the actual price at which it is sold to third parties on the Shelf, which is determined by contract in compliance with federal regulations. With respect to OCS oil, Shell determines fair market value based on the industry posted price; Shell uses that market value not only in its corporate accounting system maintained in the ordinary course of business, but also in computing royalty payments to the government pursuant to OCS leases, in establishing depletion allowances under the Internal Revenue Code, and in calculating the federal excise tax on windfall profits. The fair market value of OCS production, less related costs and expenses, represents the income earned from the extraction of oil and gas on the OCS. J.S. App. 17a; J.A. 30-34, 36-37, 43. See note 1, *supra*.[3]

[3] The following example illustrates the concept of OCS income. Suppose Shell produces 1000 barrels of OCS oil; the wellhead value of the oil is $13 per barrel, and the cost of extraction is $10,000. Shell then transports the oil ashore and refines and sells it; the shipping, refining, and marketing costs are $5,000, and the sales price for the refined oil is $25 per barrel. Shell's total net income on the sale of this oil is $10,000 ($25,000 sales price less $15,000 in costs for extraction, shipping, refining, and marketing). Of this amount, $3,000 is the net OCS income ($13,000 in wellhead value less $10,000 in extraction costs), which, we submit, the OCSLA prohibits states from taxing. The remaining $7,000 of income represents the net value added by Shell's transporting,

C. Iowa's Apportioned Tax System

Shell's principal business in Iowa consists of marketing oil and chemical products that it has refined and manufactured. It is not possible to determine whether the products sold in Iowa were derived from OCS or non-OCS oil. J.S. App. 17a-20a, 27a n.1. Shell's operations constitute a "unitary business" substantially similar to that in *Exxon Corp.* v. *Wisconsin Dept. of Revenue*, 447 U.S. 207 (1980). J.S. App. 18a. Because Shell is a unitary business, its corporate income tax in Iowa is determined under the State's apportionment methodology.

Formula apportionment is a recognized method for determining the portion of the aggregate income of a multistate unitary business that is attributable to a given state and thus taxable by that state. "[N]et income from all sources [not allocated to a specific situs], whether within or without the State, includable in the tax base * * * becomes the apportionable base to which the formula is applied." J. Hellerstein, *State Taxation* ¶ 9.1 at 478 (1983). See, *e.g.*, *Container Corp.* v. *Franchise Tax Bd.*, 463 U.S. 159, 165-166, 169 (1983); *Exxon Corp.*, 447 U.S. at 219-220. More than 40 states and the District of Columbia currently use formula apportionment to tax the income of multistate unitary businesses, and under Iowa's reading of the OCSLA each of these jurisdictions would be free to tax Shell's OCS income by including it in the apportionable income base. But see Ky. Rev. Pol. 41P130, [1 Ky.] St. Tax Rep. (CCH) ¶ 16-022 (agreeing with our position that the OCSLA prohibits apportioned state taxation of OCS income).

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refining, and marketing the oil, which states may tax because such non-OCS income is outside the OCSLA prohibition.

Section 422.33 of the Iowa Tax Code applies a one-factor apportionment formula based on sales inside and outside the State. See *Moorman Manufacturing Co.* v. *Bair*, 437 U.S. 267 (1978). As described by the Iowa District Court (J.S. App. 26a-27a):

> The formula for calculating that portion of a multistate corporation's income subject to Iowa income tax under the one factor formula is as follows:

$$\left(\frac{\text{Iowa Gross Sales}}{\text{Everywhere Gross Sales}}\right) \times \left(\begin{array}{c}\text{Federal Taxable Income}\\ \text{Adjusted Per Iowa Law}\end{array}\right) = \text{Iowa Income}$$

At issue in this case is the proper determination of the income base (*i.e.*, the adjusted "Federal Taxable Income" component above) to which the apportionment factor is to be applied to calculate Iowa income.[4] Shell submits that the OCSLA prohibits states from taxing the income earned from oil and gas that it extracted from the OCS and therefore that the net wellhead value of that production must be excluded from the income base that is apportionable among the states.[5]

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[4] In contrast to Iowa, most other apportionment jurisdictions utilize some form of three-factor formula based on payroll, property, and sales. The difference between the one-factor and three-factor methodologies does not affect the question presented in this appeal: what is to be included in the income base that is subject to apportionment.

[5] In equation form, Shell contends that the apportionable income base is:

$$\left(\begin{array}{c}\text{Federal Taxable Income}\\ \text{Adjusted Per Iowa Law}\end{array}\right) - \left(\begin{array}{c}\text{Income Earned From}\\ \text{OCS Production}\end{array}\right) = \begin{array}{c}\text{Non-OCS}\\ \text{Taxable Income}\end{array}$$

D. The Proceedings Below

This appeal involves Shell's Iowa taxes for the years 1978-1980.[6] The Iowa Department of Revenue issued a Notice of Assessment to Shell based on the inclusion of Shell's OCS income in the apportionable tax base.[7]

Because, for consistency, the apportionment factor also would have to be adjusted for OCS sales, Shell's income taxable in Iowa would be (J.S. App. 27a):

$$\left(\frac{\text{Iowa Gross Sales}}{\text{Everywhere Gross Sales} - \text{OCS Gross Sales}}\right) \times \left(\text{Non-OCS Taxable Income}\right) = \text{Iowa Income}$$

[6] In the courts below, Shell's OCS argument also encompassed the tax years 1975-1977, but the Iowa Supreme Court's decision on unrelated state-law grounds (J.S. App. 2a-7a) has now resolved those earlier years in Shell's favor.

[7] The amounts in dispute due to the OCS issue were as follows:

	Income Apportioned To Iowa		Difference In Tax On Account Of OCS Issue	
Year	Department Method ($)	Shell Method ($)	Increase (Decrease) In Tax Per Assessment ($)	Increase (Decrease) In Tax Per Assessment (%)
1975	3,457,254	3,043,554	41,369	13.7%
1976	4,473,053	3,847,942	62,511	16.3%
1977	3,741,663	3,506,061	23,460	6.7%
1978	3,698,792	3,784,909	(8,612)	(2.3)%
1979	5,584,753	4,868,861	71,590	14.8%
1980	4,671,395	3,813,008	85,839	22.7%

See J.A. 51-56. As tax year 1978 illustrates, it is possible for Shell's interpretation of the OCSLA to result in *higher* state taxes.

After the Department of Revenue rejected Shell's administrative protest (J.S. App. 36a-38a, 39a-91a), Shell sought judicial review in the Iowa District Court for Polk County. That court sustained the Department's inclusion of OCS income in the apportionable base, holding that the OCSLA does not prevent states "from indirectly taxing some portion of OCS activities pursuant to a constitutionally permissible apportionment scheme related to [the taxpayer's] sales in the taxing state" (*id.* at 31a).

The Iowa Supreme Court affirmed this ruling. J.S. App. 7a-14a. Based on the legislative history of the OCSLA, the court below construed "the language restricting the application of state taxation laws to the OCS and denying to the state any interest in the natural resources or revenues from the seabed and subsoil of the OCS [to be] intended as a limitation on the authority of states adjacent to OCS lands to extend legislative jurisdiction to the OCS" (*id.* at 10a). Given this construction, the court held that the OCSLA does not bar Iowa's taxation of Shell's OCS income (*id.* at 11a):

> [Iowa's tax] is in no way dependent upon the exercise of legislative jurisdiction on OCS lands. Its taxing jurisdiction depends instead on the nexus of Shell's activities within this state. The inclusion of some OCS revenues in the apportionment formula is simply a method of obtaining an acceptable measure of the local nexus.

The Iowa Supreme Court made clear that the State could include in the tax base Shell's earnings from *all* OCS oil and gas, whether Shell's sales of those OCS products to third parties occurred on or off the Shelf (J.S. App. 10a). The court below thus disagreed with

Shell Oil Co. v. *Department of Revenue*, 496 So.2d 789 (Fla. 1986), appeal pending, No. 86-1593 (U.S. filed Mar. 20, 1987), in which Florida conceded that the OCSLA requires income from on-Shelf sales to be excluded from apportionment.[8] Under the Iowa Supreme Court's decision, therefore, every state can tax an apportioned share of Shell's OCS income from sales on as well as off the outer Continental Shelf.

SUMMARY OF ARGUMENT

By including Shell's OCS income in the earnings base that is apportioned among the states, Iowa imposes a tax on a pro rata share of the income attributable to Shell's extraction of oil and gas from the outer Continental Shelf. We do not contest Iowa's constitutional authority under the Due Process and Commerce Clauses to apply its apportionment methodology in this manner. Rather, such taxation of OCS income

[8] In that case, a divided Florida Supreme Court upheld the State's apportioned taxation of OCS income derived from sales that occurred off the Shelf. The dissenting justices concluded that "Florida's corporate income tax law directly conflicts with federal law specifically prohibiting the application of state taxes to the outer Continental Shelf," which "Congress intended to limit state taxation power over revenues generated from drilling on the outer Continental Shelf regardless of where the sale of the oil takes place" (Shell *Florida* J.S. App. 1-18 to 1-19). Recognizing that the purpose of the OCSLA was "to give the federal government exclusive control over the development and production of [OCS resources]" (*id.* at 1-26) and that Florida's tax would mean "less [of an] incentive for companies to explore and produce oil" (*id.* at 1-34), the dissent would have held that the OCSLA "prohibits the imposition of any state tax"—whether "direct" or "indirect"—"on revenues derived [from the OCS]" (*id.* at 1-28).

runs afoul of a federal statute—the Outer Continental Shelf Lands Act. In enacting the OCSLA, Congress, as it has done in a variety of other contexts, prohibited state taxes on certain income in order to promote paramount national policies. Iowa's attempt to defend its tax on Shell's OCS income rests on a series of arguments that are unsupported by the text or history of the OCSLA and are utterly divorced from the policies of the Act.

First, Iowa asserts that apportioned income taxes constitute a unique exception to the OCSLA state tax prohibition, which, by the State's own admission, bans *all* other forms of taxation of OCS oil and gas production. Nothing in the statute, however, so much as hints at such a singular exemption for these taxes. On the contrary, the state tax prohibition is absolute and categorical: "State taxation laws," without restriction, "shall not apply" to OCS income and activities (43 U.S.C. § 1333(a)(2)(A)), and states "shall never" under the OCSLA have "any interest in or jurisdiction * * * over * * * revenues" from the OCS (43 U.S.C. § 1333(a)(3)).

Nor does the legislative history contain any suggestion that Congress intended a special rule for apportioned taxes, despite the fact that they were commonly utilized by the states and had long been in existence at the time the OCSLA was enacted. Quite the opposite, the legislative record in general, and the understanding of Senator Long in particular, clearly indicates that apportioned income taxes were subject to the state tax prohibition. Time and again, Congress rejected proposals to allow states to tax OCS oil and gas, and it fully appreciated the encompassing and unqualified scope of the provision that it adopted.

Second, Iowa's taxation of OCS income is irreconcilable with the congressional purposes underlying the OCSLA. The state tax prohibition was intended to provide an incentive for oil companies to participate in exploration and production on the Shelf, thereby both enhancing the revenues that the government would receive from the OCS leasing program and promoting the prompt development of this important energy resource for our Nation. Congress has subsequently reiterated and re-emphasized these fundamental OCS policies, which have been given increased importance by the budgetary and energy problems that have faced the country during the last two decades. Apportioned taxation of OCS income interferes with the achievement of Congress's overriding objectives in the OCSLA. See *Maryland* v. *Louisiana*, 451 U.S. 725, 753 n.26 (1981) (state taxation "would adversely affect the price which the Government could command from private developers in their bid price.")

Third, the OCSLA state tax prohibition does not, as Iowa contends, merely duplicate the established constitutional proscription of extraterritorial state taxation. The State's reading cannot be squared with the lengthy and controversial debates over the provision, which show that Congress intended the Act to be a meaningful limitation on state taxes and not a pointless repetition of existing legal principles. Moreover, the policies of the OCSLA are no less infringed by a tax that the state constitutionally has jurisdiction to impose. Iowa has not advanced any reason to gut this central statutory provision by treating it as empty surplusage.

Fourth, Iowa's position simply makes no legal or practical sense. By arguing that each state is free to

tax a proportionate part of Shell's OCS income, Iowa would allow the states collectively to do what it concedes no state can do individually: levy an income tax on the full measure of Shell's OCS production. The practical consequences of these two methods of taxation are the same for—and are equally detrimental to—the dual OCSLA policies of augmenting federal revenues and promoting OCS development. It is impossible to conclude that Congress, without a word in the statute or legislative history to that effect, would have intended to prohibit an unapportioned corporate income tax yet to permit the states cumulatively to impose the same economic burden through the device of an apportioned income tax.

Since the enactment of the OCSLA 35 years ago, the states have been unhappy about the Act's restriction on their taxing power. Iowa's position in this case is the latest example of that longstanding dissatisfaction in the specific context of apportioned income taxes. While Congress has carefully considered the states' contentions, it has consistently adhered to the prohibition on state taxation of OCS income and activities. Congress likewise has waived constitutional or statutory immunities from state taxation in a number of other areas, but it has never been persuaded to do so in the OCSLA. It should be left to Congress to resolve the states' objections to the OCSLA statutory scheme.

ARGUMENT

THE OUTER CONTINENTAL SHELF LANDS ACT PROHIBITS STATES FROM TAXING INCOME EARNED FROM THE TAXPAYER'S EXTRACTION OF OIL AND GAS ON THE OUTER CONTINENTAL SHELF

The question presented in this case is whether the Outer Continental Shelf Lands Act permits states to tax the income earned from the taxpayer's extraction of oil and gas from a federal enclave (the OCS) pursuant to federal lease. Unlike most state income tax cases that the Court has decided, this case does not involve a constitutional challenge to the validity of the apportionment formula used to prorate among the states the aggregate income of a multistate unitary business. Instead, it presents the antecedent question of what, as a matter of statutory interpretation, may be included in the income base that is subject to apportionment.

As we show below, the OCSLA requires states to exclude OCS oil and gas income from apportioned taxation. In a number of other instances, Congress has determined that significant federal interests warrant granting an immunity from state tax laws. So too, here, Congress has concluded that state taxation of income attributable to production on the outer Continental Shelf would hinder paramount federal policies in that exclusively federal domain.[9]

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[9] This case relates only to taxation of the income earned from the extraction of oil and gas on the OCS. See notes 1, 3, *supra*. States are free, ~~of course~~, to tax the portion of a taxpayer's income that is attributable to the subsequent transporting, processing, and marketing of OCS production.

A. Congress Has The Settled Power To Immunize Income From State Taxation In Order To Promote Federal Policies

To place the OCSLA in its broader context, we begin with a brief overview of Congress's authority to prohibit or limit state taxation in order to promote federal policies and protect national interests from state interference. As one leading commentator has explained, "the power of Congress to control state and local taxation, regarding federal immunity from taxation, has consistently been sanctioned by the [Supreme] Court." P. Hartman, *Federal Limitations on State and Local Taxation* § 6:5 at 248 (1981). Moreover, "[u]nder its power, Congress can * * * grant immunity to *private* parties having business relations with the Federal Government" (*ibid.* (emphasis in original)). Thus, there can be no doubt that Congress "has the power to confer upon otherwise taxable entities, having a business relationship with the Federal Government, the tax-exempt status of a federal instrumentality" (*id.*, § 6:9 at 260).

On a number of occasions, Congress has exercised this authority to create an immunity from state taxation. Perhaps the best-known illustration is 31 U.S.C. § 3124(a), which prohibits states from taxing dividend and interest income derived from federal securities. See, *e.g.*, *American Bank & Trust Co.* v. *Dallas County*, 463 U.S. 855 (1983).[10] Section 3124(a) immunizes such income from otherwise applicable state

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[10] Similar prohibitions are contained in 12 U.S.C. § 1433 (Federal Home Loan Bank), 12 U.S.C. § 1725(a) (Federal Savings and Loan Insurance Corporation), and 12 U.S.C. §§ 2055, 2079, and 2134 (Federal land banks, Federal intermediate credit banks, and Federal banks for cooperatives).

levies "to prevent taxes which diminish in the slightest degree the market value or the investment attractiveness of obligations issued by the United States in an effort to secure necessary credit." *Smith* v. *Davis*, 323 U.S. 111, 117 (1944). Iowa and other states have recognized, as they must, that Section 3124(a) prohibits the inclusion of federal securities income in a corporation's apportionable tax base, since such inclusion would enable each state to tax an apportioned share of income that Congress has put entirely beyond the states' reach. See Iowa Code Ann. § 422.35(1) (West 1971); *Continental Illinois Nat'l Bank* v. *Lenckos*, 102 Ill. 2d 210, 220-225, 464 N.E.2d 1064, 1069-1071, cert. denied, 469 U.S. 918 (1984); *First Fed. Sav. & Loan* v. *Dept. of Revenue*, 200 Mont. 358, 654 P.2d 496, 497-499 (1982), cert. denied, 462 U.S. 1144 (1983); *Federal Products Corp.* v. *Norberg*, 429 A.2d 447, 448, 449 & n.2 (R.I. 1981); *SmithKline Beckman Corp.* v. *Commonwealth*, 85 Pa. Commw. 437, 482 A.2d 1344 (1984), aff'd, 508 Pa. 359, 498 A.2d 374 (1985).

In a variety of other statutes, Congress has likewise enacted federal limitations on state taxation. For example, 49 U.S.C. § 1513(a) bars enumerated state taxes on airline gross receipts. As this Court explained in *Aloha Airlines, Inc.* v. *Director of Taxation*, 464 U.S. 7, 9 (1983), the federal government obtains substantial revenues for the Airport and Airway Trust Fund from the taxation of airline services, and Section 1513(a) preserves that source of federal revenues from the "impos[ition of] double taxation" by the states. In addition, Congress has established an "immunity from taxation" (*Lawrence* v. *Shaw*, 300 U.S. 245, 250 (1937)) for benefit payments to veterans. See 38 U.S.C. § 3101(a); *Porter* v. *Aetna*

Casualty & Sur. Co., 370 U.S. 159 (1962). Similarly, 50 U.S.C. App. § 574 precludes state income or personal property taxes on non-resident military personnel who are stationed in the state. See *Dameron* v. *Brodhead*, 345 U.S. 322 (1953). And 15 U.S.C. § 381 prohibits a state from taxing income derived within the state if the taxpayer's only in-state business activities involve the solicitation of orders. See *Heublein, Inc.* v. *South Carolina Tax Comm'n*, 409 U.S. 275 (1972). See also 15 U.S.C. § 391 and *Arizona Public Service Co.* v. *Snead*, 441 U.S. 141 (1979) (prohibition on state tax that discriminates against out-of-state manufacturers or consumers of electricity); 49 U.S.C. § 11503 and *Burlington Northern R.R.* v. *Oklahoma Tax Comm'n*, 107 S. Ct. 1855 (1987) (prohibition on discriminatory state taxation of railroads); 49 U.S.C. § 1513(d) (prohibition on discriminatory state taxation of air carriers).

Congress may of course amend the OCSLA if it becomes persuaded that, as a matter of federal policy, states should be allowed to tax OCS oil and gas income. Indeed, as this Court noted in *Garcia* v. *San Antonio Metro. Transit Auth.*, 469 U.S. 528, 552, 556 (1985), "[t]he effectiveness of the federal political process in preserving the States' interests is apparent," given the role that "our system provides [for] state participation in federal governmental action." In the past, Congress has seen fit to rescind state tax immunities that it previously enacted. See, *e.g.*, Hartman, *supra*, § 6:15 at 312-313 (Congress repealed, "as a result of protests by affected States," statutory tax immunity for federal contractors under the Atomic Energy Act). In addition, Congress in several statutes has waived constitutional protections

against state taxes.[11] But unless and until Congress takes such action here, the OCSLA stands as a barrier to state taxation of OCS income. If Iowa and other states are dissatisfied with the OCSLA scheme, it is to Congress, not this Court, that they should turn. See *Laborers Health & Welfare Trust Fund* v. *Advanced Lightweight Concrete Co.*, 108 S. Ct. 830, 837 (1988); *United States* v. *New Mexico*, 455 U.S. 720, 744 (1982).

B. Iowa's Apportioned Taxation Of Shell's OCS-Oil And Gas Income Violates The OCSLA

In its motion to dismiss (at 13), Iowa concedes that the OCSLA prohibits a wide range of state taxes on OCS income and activities. As Iowa recognizes, "any attempt by a state to impose a severance tax upon OCS production, a sales tax upon OCS wellhead sales, or a property tax upon OCS property would be clearly prohibited." Iowa also acknowledges that "a state unapportioned income tax levied upon income-generating activities in the OCS would be proscribed."

Although admitting that no state may levy a direct income tax on OCS income, Iowa argues that it

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[11] See, *e.g.*, the Buck Act, 4 U.S.C. §§ 105 *et seq.* (discussed at pages 27-28, *infra*); the Mineral Leasing Act, 30 U.S.C. § 189, and *Mid-Northern Oil Co.* v. *Walker*, 268 U.S. 45 (1925) (discussed at page 27, *infra*); 16 U.S.C. § 480 and *Wilson* v. *Cook*, 327 U.S. 474 (1946) (states have jurisdiction to impose tax in national forest); 26 U.S.C. § 3305 (states may impose unemployment tax on, *e.g.*, persons performing services on federal property); 40 U.S.C. § 290 (states may apply workers' compensation laws to federal property); *Offutt Housing Co.* v. *Sarpy County*, 351 U.S. 253 (1956) (state taxation of Air Force housing on federal property pursuant to military leasing and housing acts).

and each of the other states in which Shell does business are entirely free to impose an income tax on a pro rata share of Shell's OCS income by including that income in the apportioned tax base. Under Iowa's theory, apportioned state income taxes—alone among all state taxes—are exempt from the state tax prohibition in the OCSLA.

On its face, Iowa's submission is highly doubtful. The OCSLA and its legislative history do not contain any exception for apportioned state income taxes. Nor are such taxes compatible with the policies underlying the Act. In terms of the statutory language, history, and purpose, there is no legal or practical difference between one state directly imposing an unapportioned income tax on OCS income—which Iowa concedes would be invalid—and each of several states taxing an apportioned share of that same income. It is the economic substance of the state tax that matters, not the theoretical justification for the exaction.

To illustrate the incongruity of the State's argument, consider Iowa's apportioned taxation of Shell's OCS oil income, and assume for the sake of simplicity that Shell does business and sells its OCS oil only in that State. Because no third-party sales of oil occur on the Shelf, 100% of Shell's OCS oil income would be apportioned to—and taxed by—Iowa under its sales-factor apportionment formula. We fail to see any meaningful distinction between that tax and an income tax levied directly on Shell's OCS income by Louisiana, Texas, or Florida, which the legislative history makes clear, and Iowa itself agrees, the OCSLA prohibits. Simply stated, Iowa's position would permit the states to "do indirectly that which [they are] prohibited from doing di-

rectly." *Continental Illinois*, 102 Ill. 2d at 223, 464 N.E.2d at 1070.

It may be helpful in this regard to imagine a corporation whose offshore oil and gas operations are conducted by a separate subsidiary that does business only on the outer Continental Shelf. What Congress has done in the OCSLA is, in effect, to immunize the income of that subsidiary, doing business solely within a federal enclave, from state taxation. In other words, the states are prohibited from including the net income of the OCS subsidiary in the parent corporation's income base for purposes of apportioned taxation. Iowa's taxing scheme plainly runs afoul of that requirement.

Iowa nonetheless seeks to justify its anomalous position by asserting that—even though OCS income unquestionably is included in the apportionable tax base that is used to determine the taxable income for each state—its apportionment methodology does not "tax[] a portion of [Shell's OCS] earned income" (Mot. to Dis. 10). In the State's view, its apportioned state income tax "does not inherently tax OCS activities, merely because OCS revenues and expenses are included within the apportionment" (*id.* at 13).

Iowa's characterization of apportioned taxation is simply incorrect. Contrary to the State's assertion, apportionment does result in a tax on Shell's OCS income. Moreover, such taxation is squarely prohibited by the OCSLA.

1. ***Iowa's Apportionment Methodology Taxes Shell's OCS Income***

Iowa's income tax indisputably imposes a levy on the income Shell earned from the extraction of oil

and gas from the OCS pursuant to federal lease. That income, by virtue of its inclusion in Shell's apportionable income from sales of OCS oil and gas, is reflected in Iowa's pro rata share of income that is the basis for computing Shell's tax liability to the State.

Indeed, the very theory of apportioned taxation demonstrates that Iowa is taxing Shell's OCS income. Under formula apportionment, "all the apportionable net income from a multistate business is first determined, and it is then apportioned according to the relevant formula to the particular State." Hartman, *supra*, § 9:18 at 523. In this way, " 'the entire net income of a corporation * * * [is] apportioned among the States for tax purposes.' " *Exxon Corp.* v. *Wisconsin Dept. of Revenue*, 447 U.S. 207, 219 (1980) (citation omitted). Given this division of total income, it is clear, as this Court has recognized, that apportionment "subject[s] to taxation * * * income derived from the extraction of oil and gas located outside the State" (*id.* at 210). See also *Moorman Manufacturing Co.* v. *Bair*, 437 U.S. 267, 272 (1978) (apportionment "may result in taxation of some income that did not have its source in the taxing State"); *Mobil Oil Corp.* v. *Vermont Comm'r of Taxes*, 445 U.S. 425, 440 (1980) (apportionment "include[s] income earned from [taxable events that occur outside the state] in the preapportionment tax base"); J. Hellerstein, *State Taxation* ¶ 9.1 at 478 n.1 (1983) (citation omitted) (" '[i]n * * * apportionment, the taxpayer's normal or business income is mathematically divided among the various jurisdictions in which it does business to determine the measure of local tax' ").[12]

[12] The Iowa District Court acknowledged that Iowa and other apportionment states were "indirectly taxing some por-

Moreover, this conclusion is confirmed by the evidence in this case. In each of the tax years reflected in the record (see page 10, note 7, *supra*), Iowa's inclusion of Shell's OCS operations in its apportionment methodology affected the amount of Shell's income that was taxable by the State. And in all but one of those years, inclusion of Shell's OCS activities increased the tax due the State. Thus, Shell's OCS income is clearly encompassed in the income that Iowa is taxing.

In sum, Iowa—and each of the more than 40 other states that have an apportioned corporate income tax (except Kentucky, see page 8, *supra*)—claims the right to tax an allotted portion of Shell's OCS income by attributing a percentage of that income to Shell's transactions that occur in the State. While Iowa may have the constitutional power to value in-state transactions under that apportionment theory, there can be no doubt that in doing so the State has taxed Shell's OCS income. The question presented here is whether such taxation is consistent with the OCSLA. As demonstrated by the text, history, and policies of the Act, the answer to that question is "no."

2. *The Plain Language Of The OCSLA Prohibits Iowa's Tax On Shell's OCS Oil And Gas Income*

"The starting point in statutory interpretation is 'the language of the statute itself.'" *United States* v. *James*, 106 S. Ct. 3116, 3121 (1986) (citation omitted). That language "'must ordinarily be regarded as conclusive'" absent a "'clearly expressed legislative intention to the contrary.'" *Id.* at 3122 (citation omitted). Here, the plain language of the OCSLA prohibits Iowa from taxing Shell's earnings from the extraction of oil and gas from the OCS.

tion of [Shell's] OCS activities" (J.S. App. 31a). However, it erroneously believed that such taxation was not inconsistent with the OCSLA because it occurred "pursuant to a constitutionally permissible apportionment scheme related to Shell's sales in the taxing state" (*ibid.*).

By its express terms, the OCSLA asserts the "jurisdiction" and "control" of the United States over the OCS (43 U.S.C. § 1332(1)) as a "vital national resource reserve" that "should be made available for expeditious * * * development" (43 U.S.C. § 1332 (3)). Accordingly, in extending the Constitution and laws of the United States to the Shelf, the Act provides that the OCS is "an area of exclusive Federal jurisdiction" (43 U.S.C. § 1333(a)(1)).

Under settled principles, states cannot impose a tax on private property or persons within an area of exclusive federal jurisdiction, absent the consent of Congress. Exclusive federal jurisdiction "is in essence complete sovereignty. That is, not only is the federal property immune from taxation because of the supremacy of the Federal Government but state laws, not adopted directly or impliedly by the United States, are ineffective to tax or regulate other property or persons upon that enclave." *S.R.A., Inc.* v. *Minnesota*, 327 U.S. 558, 562-563 (1946). Thus, "[w]herever the United States has such jurisdiction the State would have no authority to lay the tax." *James* v. *Dravo Contracting Co.*, 302 U.S. 134, 140 (1937). In *Humble Pipe Line Co.* v. *Waggonner*, 376 U.S. 369 (1964), for example, the Court applied these principles to hold that the state could not tax a private party who had leased land in an exclusive federal enclave to develop oil and gas reserves. Similarly, in *Ramah Navajo School Bd.* v.

New Mexico Bureau of Revenue, 458 U.S. 832 (1982), the Court held that the state could not impose a gross receipts tax on a non-Indian construction company engaged in building a school on an Indian reservation. See also *White Mountain Apache Tribe* v. *Bracker*, 448 U.S. 136 (1980), discussed at page 37, note 45, *infra*.

Given the explicit provision in Section 1333(a)(1) that the outer Continental Shelf is an area of exclusive federal jurisdiction, this analysis normally would be sufficient to prevent state taxation based on OCS activities. However, because 43 U.S.C. § 1333(a)(2)(A) incorporates certain state laws as surrogate federal law applicable to the OCS (see page 4, *supra*), Congress could not rest with the general preemptive implications of exclusive federal jurisdiction. Instead, it affirmatively exercised its plenary authority over federal property (see, *e.g.*, *Kleppe* v. *New Mexico*, 426 U.S. 529, 540-546 (1976)) to enact two additional provisions that confirm the invalidity of state taxation of income earned from the extraction of OCS oil and gas.

First, in language that is noteworthy for its clarity and directness, Congress declared: "State taxation laws shall not apply to the outer Continental Shelf" (43 U.S.C. § 1333(a)(2)(A)). It is hard to imagine simpler or more sweeping language to prohibit state taxation of the income attributable to the production of oil and gas on the Shelf.

Second, Congress provided that the OCSLA "shall never be interpreted" as a basis for a state to claim "any interest in or jurisdiction * * * over * * * the revenues" from the OCS (43 U.S.C. § 1333(a)(3)). This emphatic prohibition precludes Iowa not only

from asserting jurisdiction over the OCS but also from claiming "any interest in" Shell's apportioned "revenues" from OCS oil and gas.

Other provisions of the OCSLA confirm the view that state taxation of OCS activities is impermissible. For example, the Mineral Leasing Act of 1920, 30 U.S.C. § 189, expressly allows states "to levy and collect taxes upon * * * any lessee of the United States." See *Commonwealth Edison Co.* v. *Montana*, 453 U.S. 609, 631-632 (1981). However, Congress chose to make the Mineral Leasing Act inapplicable to the OCS by providing that "mineral leases on the outer Continental Shelf shall be maintained or issued only under the provisions of [the OCSLA]" (43 U.S.C. § 1333(a)(1)).

Significantly, Congress also did not extend the Buck Act to the OCS. The Buck Act of 1940, 4 U.S.C. §§ 105-110, constitutes congressional authorization for states to impose specified taxes on people or property in federal areas. See *United States* v. *Mississippi Tax Comm'n*, 421 U.S. 599, 603, 611 (1975). In particular, 4 U.S.C. § 106 provides that a state shall have "full jurisdiction and power to levy and collect" income taxes in any federal area within the state, and that "[n]o person shall be relieved from liability for any income tax levied by any State * * * by reason of his * * * receiving income from transactions occurring or services performed" in a federal area. However, because the Buck Act is restricted to federal areas "located within the exterior boundaries" of a state (4 U.S.C. § 110(e)), it is inapplicable to the OCS. The failure of the OCSLA to incorporate the Buck Act's specific authorization for state income taxes is telling evidence that rein-

forces the conclusion that states may not tax the income Shell earned from the extraction of OCS oil and gas.

3. *The Legislative History And Policies Of The OCSLA Preclude Iowa's Tax On Shell's OCS Oil And Gas Income*

Where, as here, the express provisions of a federal statute prohibit a state tax, it is unnecessary for courts to look behind the statute to consider the legislative history and congressional policies underlying the prohibition. See, *e.g.*, *Aloha Airlines*, 464 U.S. at 12. In any event, the history and purposes of the OCSLA further demonstrate that Iowa's tax on Shell's OCS oil and gas income is invalid.

a. *The 1953 OCSLA Statute*

i. The OCSLA was originally enacted in 1953. The legislative history of that statute is extensive, involving a number of separate bills introduced and debated over several Congresses. But for present purposes, one feature of this history stands out: the states made repeated attempts to obtain tax or lease revenues from the OCS, which Congress consistently rejected in order to preserve exclusive federal jurisdiction over, and exclusive federal revenues from, the OCS.

Numerous proposals were introduced in Congress to enable states to share directly or indirectly in the wealth of the OCS. These included proposals: to extend state police powers, including the taxing power, to the OCS;[13] to permit the states to impose

[13] See H.R. Rep. No. 695, 82d Cong., 1st Sess. 7, 13 (1951); *Outer Continental Shelf: Hearings on S. 1901 Before the Senate Comm. on Interior and Insular Affairs*, 83d Cong., 1st Sess. 471 (1953).

severance or production taxes but to exclude all other forms of taxation;[14] to apply the Mineral Leasing Act to the OCS, which would have allowed the states to levy taxes (see page 27, *supra*);[15] to provide states with a portion of the royalties paid to the United States for OCS leases;[16] to establish a joint congressional committee to determine federal reimbursement to the states for services provided to OCS lessees and their employees;[17] and to use the proceeds of OCS leases for grants to public education, which would have redounded largely to the financial benefit of the states.[18]

All of these proposals rested on two basic arguments. First, states contended that it was unfair to treat them differently under the OCSLA than under the Mineral Leasing Act, which authorized states to tax and gave them a portion of the federal revenues from lease and royalty payments. Second, states argued that development of the OCS would result in increased costs for on-shore state services that should in fairness be funded by OCS taxes or revenues.[19] In

[14] See H.R. Rep. No. 215, 83d Cong., 1st Sess. 7-8 (1953).

[15] See S. Rep. No. 411, 83d Cong., 1st Sess. 27, 37 (1953); 99 Cong. Rec. 6966 (1953) (remarks of Sen. Cordon).

[16] See S. Rep. No. 411 at 3.

[17] See 99 Cong. Rec. 7251-7255 (1953).

[18] See S. Rep. No. 411 at 2-3.

[19] See S. Rep. No. 411 at 3; *id.* at 65-68 (minority report); 99 Cong. Rec. at 2505 (remarks of Rep. Willis); *id.* at 2510 (remarks of Rep. Wilson); *id.* at 2548 (remarks of Rep. Thompson); *id.* at 4887 (remarks of Rep. Wilson); *id.* at 7226-7227, 7228 (remarks of Sen. Ellender); *id.* at 7231, 7251, 7252 (remarks of Sen. Long); *id.* at 7259 (remarks of Sen. Daniel); *id.* at 7260-7263 (remarks of Sen. Long).

the end, however, Congress was unpersuaded by the states' arguments and defeated all of their proposals. Both the House bill (whose language was incorporated in 43 U.S.C. § 1333(a)(2)(A)) and the Senate bill (whose language was incorporated in 43 U.S.C. § 1333(a)(3)) were in agreement that the states were not entitled to *any* part of the tax or lease revenues from the OCS.[20]

ii. The power of the states to tax OCS activities was repeatedly discussed and emphatically denied by Congress. For example, the Senate Report on the OCSLA explained that state taxation laws "necessarily are excluded" from the OCS, a proposition that Section 1333(a)(3) made "plain" in "precise unequivocal language."[21] Similarly, Representative Keating, in introducing the amendment to the House bill that eventually was enacted as the state tax prohibition in Section 1333(a)(2)(A), referred to the position of the Secretary of the Interior that states "should have no taxing power whatsoever on the outer Continental Shelf" and "should be given nothing from the resources."[22] In the words of the Conference Report, "State taxation laws are specifically banned."[23]

Congress well understood the absolute and sweeping nature of the prohibition on state taxes. Representative Boggs, in a colloquy with Representative Keating, explained that the Keating amendment

[20] See H.R. Conf. Rep. No. 1031, 83d Cong., 1st Sess. 12 (1953).

[21] See S. Rep. No. 411 at 3, 23, 11.

[22] 99 Cong. Rec. at 2572.

[23] H.R. Conf. Rep. No. 1031 at 12.

"strikes out any participation by the States in the taxing of these resources."[24] Likewise, Representative Brooks observed that OCS lessees would be "immune to State and local laws as far as taxes are concerned."[25] And Representative Willis noted that "taxing powers" were "completely denied to the States."[26] The Senate debates equally reflected that "the sole jurisdiction, control, and right to tax *in any form* is in the United States"[27] and that states would not be permitted to "tax[] private lessees engaged in operations on the outer shelf."[28]

With respect to the specific question presented in this case, the most pertinent portions of the legislative history are the statements of Senator Long of Louisiana, who was a member of the Senate Committee that considered the OCSLA and whose state was intensely interested in the taxing and revenue provisions in the statute. Senator Long correctly perceived the restrictions on state taxing power that are controlling here. In particular, noting in the Senate Report that the Act "den[ied] the States any power of taxation,"[29] Senator Long recognized that OCS lessees would be "subject neither to the State's severance tax, property tax, *nor the tax on corporate profits*."[30] He later reiterated these points on the

[24] 99 Cong. Rec. at 2572.

[25] *Id.* at 2577.

[26] *Id.* at 4883.

[27] *Id.* at 7234 (remarks of Sen. Cordon) (emphasis added).

[28] *Id.* at 7259 (remarks of Sen. Daniel).

[29] S. Rep. No. 411 at 65 (minority report).

[30] *Id.* at 67 (emphasis added).

floor, adding that OCS lessees "are beyond the reach of the State." [31] At no time in the legislative debates on the OCSLA did anyone express disagreement with Senator Long or correct his understanding of the Act.

Thus, Senator Long expressly acknowledged that the OCSLA would prohibit state taxation of OCS income. At the same time, Senator Long understood that OCS development would require lessees to have substantial on-shore operations, which could be taxed by the states.[32] In light of that taxable activity, it is quite clear that Senator Long's construction of the OCSLA state tax prohibition was directed at state income taxes on the profits from OCS oil and gas production.

It is, in addition, of particular significance here that Louisiana in fact had an apportioned corporate income tax in 1953.[33] Senator Long undoubtedly was aware of that tax, which Louisiana had first enacted in the 1930s. Therefore, Senator Long's unqualified conclusion that OCS income was not "subject * * * to * * * the tax on corporate profits" and was "beyond the reach of the State" clearly establishes that such income could not be taxed under a state apportionment methodology.

Indeed, of the 36 states and territories (including the District of Columbia, Alaska, and Hawaii) that had a corporate income tax in 1953, *all of them* ap-

[31] 99 Cong. Rec. at 7260-7261.

[32] See S. Rep. No. 411 at 67 (minority report); 99 Cong. Rec. at 7261 (remarks of Sen. Long).

[33] See G. Altman & F. Keesling, *Allocation of Income in State Taxation* 17-18, 143-144, 166-168 (2d ed. 1950).

pear to have used formula apportionment to tax multistate unitary businesses.[34] As early as 1921, the National Tax Association had prepared a model bill for the apportionment of business income,[35] and by 1939 all but one of the 32 jurisdictions with a corporate income tax apportioned the income of interstate companies.[36] And, as Iowa pointed out in its motion to dismiss (at 7 n.7), this Court had "firmly established" the constitutionality of formula apportionment in a series of decisions beginning in 1920. Yet against this background, there is nothing in the text of the OCSLA that exempts apportioned income taxes from the state tax prohibition, nor is there even a word in the lengthy legislative history to suggest that Congress meant to carve out such an exception. See *Church of Scientology of California* v. *IRS*, 108 S. Ct. 271, 276 (1987). The *only* specific reference to corporate income taxation is to the contrary. In these circumstances, Congress's silence regarding a special rule for apportioned state taxation of OCS income speaks volumes.

iii. Congress's determination to prohibit state taxation of OCS oil and gas income reflected two important considerations. To begin with, Congress understood, contrary to the states' contention, that the outer Continental Shelf is not analogous to federal lands within a state that are covered by the Mineral Leasing Act. Rather, the OCS was regarded

[34] *Ibid.*

[35] See J. Hellerstein, *State Taxation* ¶ 8.6 at 334 n.120 (1983).

[36] National Tax Ass'n, *Proceedings of the Thirty-Second Annual Conference on Taxation—1939*, at 192 (1940).

as "peculiarly a matter of" federal concern [37] and "uniquely an area of exclusive Federal jurisdiction and control." [38] OCS lands "are wholly outside the boundary of any State," [39] and—as this Court recognized in its decisions in the *California*, *Louisiana*, and *Texas* cases—the "States never had title to this territory." [40] As Senator Cordon explained:

> The difference lies in the fact that the area of the Continental Shelf is not within States; it is an area outside the States.
>
> * * * * *
>
> [W]ith respect to the States which do receive such a percentage of income [under the Mineral Leasing Act], the only basis for it is that those States have reserved from private ownership vast areas of public domain. The Senator's State of Louisiana and all the eastern States, on the other hand, derive the full value from all land and natural resources within their boundaries.[41]

Thus, " '[t]he situation is not comparable to that of federally owned areas within a State * * *.' " [42] In-

[37] S. Rep. No. 411 at 6.

[38] 99 Cong. Rec. at 6963 (remarks of Sen. Cordon).

[39] *Id.* at 10472 (remarks of Sen. Cordon). See also *id.* at 7231 (remarks of Sen. Cordon).

[40] *Id.* at 2499 (remarks of Rep. Celler).

[41] *Id.* at 7254-7255. See also S. Rep. No. 146, 99th Cong., 1st Sess. 267 (1985) (letter from Secretary of the Interior Hodel) (the Mineral Leasing Act "was meant to provide funds to States because of their inability to tax Federal lands within their borders. Since the [OCS] areas are outside State borders, no similar loss of tax revenue occurs").

[42] S. Rep. No. 411 at 6.

stead, the OCSLA was considered to be "unique legislation" that recognized "that the assets obtained from [the OCS] shall be regarded as purely and wholly Federal assets, and that the profits obtained therefrom shall be regarded as profits belonging to the Federal Government and as revenue of the Federal Government." [43]

Moreover, Congress concluded that state taxation of OCS oil and gas would obstruct the paramount federal policies that the OCSLA was designed to foster: *first*, state taxes would diminish federal revenues from OCS leases and hence limit the benefits of the leasing program for the United States Treasury; and *second*, such taxes would impair the national interest in the prompt development of OCS resources.

Representative Keating noted the first concern in connection with his amendment to prohibit state taxes. He explained that state taxes on OCS oil and gas would decrease the net value of the leases and thus reduce the amounts lessees would be willing to pay to the government:

> My concern is for the taxpayers of the United States, for in truth it would be their money we would be generous with, if we leave the present wording in the bill.
>
> The tax imposed by the adjacent States would fall, at least indirectly, on the United States, the landlord of this area, since the terms of any lease entered into would have to be fixed in order

[43] 99 Cong. Rec. at 7252 (remarks of Sen. Holland).

> to permit the lessees a fair return and a proper incentive to develop the area.[44]

The Solicitor General agrees that Congress recognized that state taxation of OCS oil and gas "would necessarily decrease federal revenues" (U.S. *Florida* Am. Br. 15 n.11, citing 99 Cong. Rec. at 2571 (remarks of Rep. Keating)). Thus, as this Court cautioned in *Maryland* v. *Louisiana*, 451 U.S. 725, 752-753 n.26 (1981), "[t]he proper fee or charge for drilling * * * on the OCS is a determination which is *solely* within the province of the Federal Government," and "[p]ermitting the States to exercise such power [of taxation] would *adversely affect the price which the Government could command from private developers in their bid price*" (second emphasis added).

In the same way, state taxation of OCS oil and gas income would, as Representative Keating observed in the foregoing remarks, impede a "fair return" to lessees and interfere with the "proper incentive" for them to develop the OCS. In 43 U.S.C. § 1332(3), Congress declared as a matter of federal policy that the OCS "is a vital national resource reserve" that "should be made available for expeditious * * * development." See also, *e.g.*, H.R. Rep. No. 413, 83d Cong., 1st Sess. 2 (1953) (the "principal purpose" of the OCSLA was to authorize the leasing and development of the OCS, and the "importance and necessity" for the legislation reflected the congressional policy that "the development and operation of [the OCS] are vital to our national economy and security"). State taxes would burden this national policy; as Congress itself recognized with respect to royalties, payments should not be "made so high that companies will not feel like operating the lands."[45]

[44] 99 Cong. Rec. at 2571. Other members of Congress noted that state taxes would "bring about an increased cost in the price of oil and gas" to consumers throughout the country (*id.* at 2527 (remarks of Rep. Madden)), including the United States in its purchases of oil for the national defense (*id.* at 2535 (remarks of Rep. Yates)).

b. *The 1978 OCSLA Amendments*

Congress amended the OCSLA in 1978, primarily to provide for alternative bidding systems for OCS leases. In enacting the 1978 amendments, Congress reiterated and reinforced the fundamental policies of the OCSLA: to enhance the government's revenues from OCS lease payments, and to promote development of the OCS through incentives to lessees.

The 1978 amendments make clear the importance of the government's financial interest in OCS leases. This Court has recognized that "[i]n passing the 1978 Amendments, Congress committed the Government to the goal of obtaining fair market value for

[45] *Id.* at 6965 (remarks of Sen. Martin).

In analogous circumstances in *White Mountain Apache Tribe* v. *Bracker*, *supra*, the Court held that a state could not impose a tax on non-Indian logging companies operating on a federal Indian reservation because such taxation would interfere with the federal "policy of assuring that the profits derived from timber sales will inure to the benefit of the Tribe" and "would undermine the Secretary's ability to make the wide range of detetrminations committed to his authority concerning the setting of fees and rates with respect to the harvesting and sale of tribal timber"; as a result, state taxes would impermissibly "reduc[e] tribal revenues and diminish[] the profitability of the enterprise for potential contractors." 448 U.S. at 149.

OCS oil and gas resources." *Watt* v. *Energy Action Educational Foundation*, 454 U.S. 151, 162 (1981). See 43 U.S.C. § 1344(a)(4) ("[l]easing activities shall be conducted to assure receipt of fair market value for the lands leased and the rights conveyed by the Federal Government"); H.R. Conf. Rep. No. 1474, 95th Cong., 2d Sess. 92 (1978) ("the new bidding alternatives * * * should * * * [p]rovid[e] a fair return to the Federal Government"). The 1978 amendments were specifically intended to " 'secure higher returns to the public Treasury' " (454 U.S. at 167 n.18, quoting H.R. Rep. No. 590, 95th Cong., 1st Sess. 47 (1977)).[46]

This fiscal concern is of particular significance because of the substantial importance of OCS payments to the federal budget. As noted above (see pages 5-6, *supra*), the federal government received more than $80 billion in OCS payments during the period 1954-1985. These payments currently amount to approximately $4 billion annually and have exceeded $10 billion in some years. See Office of Management and Budget, *Budget of the United States Government—Fiscal Year 1988 (Supp.)* 5-171, 6c-20, 6c-42. Indeed, in 1983, Congress stated that "[f]ederal revenues received from outer continental shelf oil and gas exploration and development activities represent one of the largest sources of income to the U.S. Treasury, behind only Internal Revenue Service

[46] Furthermore, by authorizing the Secretary of the Interior to experiment with systems of lease payments based on lessees' net OCS profits (see 454 U.S. at 155 & nn.3, 5), the 1978 amendments give the government a direct interest in the profitability of OCS production (*id.* at 166-167 n.18)—an interest that would be adversely affected by state taxation of OCS oil and gas income.

income taxes." H.R. Rep. No. 206, 98th Cong., 1st Sess. 59 (1983); see also S. Rep. No. 112, 98th Cong., 1st Sess. 13 (1983).

Likewise, the 1978 amendments were intended, as Section 102 states, to make OCS oil and gas resources "available to meet the Nation's energy needs as rapidly as possible" through "expedited exploration and development of the Outer Continental Shelf."[47] The Conference Report "emphasize[d] the need for the expeditious * * * exploration and development of the Outer Continental Shelf," and it stressed the importance of "avoiding unnecessary delays in exploration, development, and production," of "discovering and recovering oil and gas," and of "developing new oil and gas resources in an efficient and timely manner."[48] To that end, the amendments were intended to " 'provid[e] the incentive of a fair profit to the oil companies, which must risk their investment capital,' "[49] and to " 'increase the availability of funds for exploration.' "[50] Congress was well aware of the "vast amounts of capital" necessary to bid on and develop OCS tracts and the "increasing risks of uncertainty" in OCS projects, including "[t]he lack of experience in frontier areas" and the "deeper OCS depths requiring more sophis-

[47] See H.R. Conf. Rep. No. 1474 at 4.

[48] *Id.* at 76, 92. See *Watt* v. *Energy Action Educational Foundation*, 454 U.S. at 164 n.16; *Secretary of Interior* v. *California*, 464 U.S. 312, 336 (1984).

[49] 454 U.S. at 164 n.16, quoting H.R. Rep. No. 590 at 54. See 124 Cong. Rec. 26778 (1978) (remarks of Rep. Murphy).

[50] 454 U.S. at 166 n.18, quoting S. Rep. No. 284, 95th Cong., 1st Sess. 46-47 (1977). See 124 Cong. Rec. at 26778 (remarks of Rep. Murphy).

ticated and expensive equipment and technologies." [51] Thus, "we are now in a period in which investment capital is tight * * * and the risks high." [52]

Congress's affirmation of the OCSLA policy to promote development of the OCS came against the background of the Nation's energy crisis of the 1970s:

> [The 1978 amendments are necessary to] expedite the systematic development of the OCS * * *.
>
> The United States is becoming increasingly dependent on foreign sources of oil. This dependence must be reduced. * * * The basic purpose of [the 1978 amendments] is to promote the swift, orderly and efficient exploitation of our almost untapped domestic oil and gas resources in the Outer Continental Shelf. During the 1980's, oil and gas development on the OCS is likely to be one of the single largest sources of additional domestic energy, and at a lower expense than most alternatives in terms of development and impact costs.[53]

[51] H.R. Rep. No. 590 at 47, 54, 94. See S. Rep. No. 284 at 49 ("Many dollars of investment and much effort separate [proved reserves] from [potential reserves]"); 124 Cong. Rec. at 1629 (remarks of Rep. Murphy) ("[e]ven the larger oil companies * * * [are having] capital formation problems"); *id.* at 1630 (remarks of Rep. Miller) ("massive amounts" of capital are necessary for leasing); *id.* at 1633 (remarks of Rep. Miller) (oil in "the frontier areas * * * is more expensive to develop").

[52] *Id.* at 26778 (remarks of Rep. Murphy).

[53] H.R. Rep. No. 590 at 53. See *id.* at 103 ("offshore production 'can be the largest domestic source of oil and gas between now and the 1990's,'" and "the only substantial new source of domestic oil and gas will be found in the OCS").

Accordingly, OCS development was expected to "provide one of the largest single sources of increased domestic energy" and to "supply this energy at a lower average cost to the U.S. economy than many other alternatives" and "with substantially less harm to the environment than most other sources." [54] Congress viewed "expedited exploration and development of the" OCS as essential "in order to achieve national economic and energy policy goals, assure national security, reduce dependence on foreign sources, and maintain a favorable balance of payments in world trade." [55] In view of these urgent concerns, as Representative Murphy observed in introducing the Conference Report, "[t]he importance of OCS resources to the United States * * * cannot be overstated," and "it is vital that we develop these resources as rapidly as modern technology will safely permit." [56]

In sum, Congress in enacting the OCSLA in 1953 sought to preserve OCS revenues for the federal treasury and to encourage development of the OCS. The state tax prohibition was an integral aspect of the federal program for accomplishing these goals. In the 1978 amendments to the OCSLA, Congress reaffirmed those objectives, which had assumed even greater importance in light of the pressing budgetary and energy needs of the country. Because Iowa's attempt to tax Shell's OCS income is flatly inconsistent with these purposes of the OCSLA, it must give way to the national interest.

[54] S. Rep. No. 284 at 42.

[55] H.R. Conf. Rep. No. 1474 at 4.

[56] 124 Cong. Rec. at 26779.

4. *The OCSLA Prohibition Of State Taxation Is Not Redundant Of The Constitutional Restrictions On State Taxes*

With virtually no reference to the language, history, or policies of the OCSLA, Iowa asserts (Mot. to Dis. 14-17) that the state tax prohibition merely codifies the constitutional proscriptions already embodied in the Due Process and Commerce Clauses against a state's taxation of values that are outside its territorial jurisdiction. That interpretation, however, renders the statutory provision superfluous and largely trivializes Congress's extensive and often contentious debate over the issue of state taxing authority. The Congress that enacted the OCSLA—and the subsequent Congresses that have considered questions of OCS development and national energy policy—certainly thought that the statute did something more than simply incorporate a well-established and indisputable constitutional principle.

Iowa makes no effort to square its pointless reading of the OCSLA with the clear language that Congress employed in Sections 1333(a)(2)(A) and 1333(a)(3): "State taxation laws shall not apply to the outer Continental Shelf," and the OCSLA "shall never be interpreted as a basis for [a state's] claiming any interest in * * * the property and natural resources [of the OCS] or the revenues therefrom." Iowa makes no effort to square its reading with the legislative history of the OCSLA—and especially Senator Long's statements—that Congress intended to prohibit all state taxes on OCS income and activities. And Iowa makes no effort to square its reading with the overriding policies of the OCSLA—to maximize federal revenues and to promote OCS development—which are impaired by any

state tax on OCS income and activities, not just those for which the state constitutionally lacks jurisdiction.

Moreover, Iowa's proffered interpretation, by treating the state tax prohibition as a nullity, is irreconcilable with fundamental rules of statutory construction. It is a "basic axiom" that "courts should construe all legislative enactments to give them some meaning." *Rosado* v. *Wyman*, 397 U.S. 397, 415 (1970). Under this " 'elementary canon of construction,' " courts have the " 'duty to give effect, if possible, to every clause and word of a statute * * *, rather than to emasculate an entire section.' " *South Carolina* v. *Catawba Indian Tribe*, 106 S. Ct. 2039, 2046 n.22 (1986) (citations omitted). This Court should not "lightly" accept Iowa's invitation to "conclude that [the] congressional enactment has no purpose or function." *Mercantile Nat'l Bank* v. *Langdeau*, 371 U.S. 555, 560 (1963).

In the end, the language, history, and policies of the OCSLA convincingly establish that the Act was intended to prohibit state taxation, in *any* form, of OCS oil and gas income. At every turn, Congress rebuffed the states' efforts to reap tax revenues from the OCS. The OCSLA bars "[s]tate taxation laws" without exception, and Congress meant the statute to be a significant additional restriction on the states, not a meaningless repetition of the existing constitutional ban on extraterritorial state taxation. Furthermore, Congress explicitly prohibited state attempts to claim "any interest in" the revenues from OCS oil and gas production, whether based on assertions of jurisdiction or otherwise. The Court should reject Iowa's attempt to convert these important

statutory provisions into useless and expendable redundancies.

5. *At A Minimum, The OCSLA Prohibits State Taxation Of OCS Income Earned From Sales To Third Parties On The Shelf*

For the foregoing reasons, we submit that the OCSLA prohibits Iowa's apportioned tax on any of Shell's OCS oil and gas income. If the Court disagrees with that contention, however, it should construe the Act to bar state taxation of income earned from OCS production that is sold to a third party on the Shelf itself. In the related case of *Shell Oil Co.* v. *Department of Revenue, State of Florida*, appeal pending, No. 86-1593 (filed Mar. 20, 1987), Florida has "concede[d] that any revenues which Shell derives from actual sales consummated on the OCS oil platforms are beyond the reach of Florida's taxing power as limited by section 1333(a)(2) [of the OCSLA]." See Shell *Florida* J.S. App. 1-8. That concession is compelled by the OCSLA.

With respect to OCS oil and gas that is sold on the Shelf, the applicability of the OCSLA state tax prohibition is manifest. The income being taxed consists of nothing but the net value of the resources extracted from the OCS. That production has no geographical nexus to any area but the OCS at the time it is conveyed by the taxpayer-lessee. And all of the events giving rise to the lessee's tax liability for the income earned—the extraction of the oil and gas and the realization of gain through its sale—have occurred within this exclusive federal enclave. In the most literal sense, state taxes have, in contravention of the OCSLA, been "appl[ied] to the outer Continental Shelf" (43 U.S.C. § 1333(a)(2)(A)),

and the state has "claim[ed]" an "interest" in the apportioned "revenues" from OCS activities (43 U.S.C. § 1333(a)(3)).

Moreover, the dual policies underlying the OCSLA —to promote development of the OCS through incentives to lessees, and to enhance the government's revenues from lease payments—are most directly implicated in this situation. To tax the income of an OCS lessee who extracted and sold minerals entirely on the Shelf would impose a direct burden on the profitability of the OCS operation, thereby reducing the lessee's incentive to undertake development and lowering the value of the rights for which lease payments will be made to the government.

Accordingly, as Florida correctly recognizes, the OCSLA requires at a minimum that state taxes exclude from the apportionable income base the earnings attributable to oil and gas that the taxpayer-lessee extracts from the OCS and sells to a third party on the Shelf.

CONCLUSION

The judgment of the Supreme Court of Iowa should be reversed.

Respectfully submitted.

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In The

Supreme Court of the United States

October Term, 1987

SHELL OIL COMPANY,
Appellant,

v.

THE IOWA DEPARTMENT OF REVENUE,
Appellee.

On Appeal from the Supreme Court of Iowa

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QUESTION PRESENTED

Whether the Outer Continental Shelf Lands Act Precludes the State of Iowa From Imposing a Tax Upon That Portion of a Unitary Net Income Base Which is Reasonably Attributable to the Taxpayer's Income Producing Activities in Iowa.

PARTIES TO PROCEEDINGS BELOW

The parties before the Supreme Court of Iowa with respect to the question presented were Shell Oil Company and the Iowa Department of Revenue.

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No. 87-984

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In The
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October Term, 1987

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SHELL OIL COMPANY,
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THE IOWA DEPARTMENT OF REVENUE,
Appellee.

—o—

On Appeal from the Supreme Court of Iowa

—o—

BRIEF FOR THE APPELLEE

—o—

OPINIONS BELOW

The opinion of the Supreme Court of Iowa (J.S. App. 1a-14a) is reported at 414 N.W.2d 113. The opinion of the District Court of Polk County (J.S. App. 15a-35a) is not reported.

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STATEMENT OF THE CASE

Shell Oil Company (Shell) is engaged in business in all fifty States and in the District of Columbia. (J.A. 13). In the years 1975 through 1980, Shell's principal business activities in the United States were the exploration for, and development, production, transportation, purchase, and marketing of crude oil and natural gas, and the purchase, manufacture, and marketing of oil and chemical products. (J.A. 13-14). The parties agree that Shell's operations, including those in Iowa and in the outer Continental Shelf (OCS), constitute a single unitary business similar to those in *Exxon Corp. v. Wisconsin Department of Revenue,* 447 U.S. 207 (1980). (J.A. 20).

During the years 1975 through 1980, Shell conducted most of its business activities between two internal operating divisions, known as the Exploration and Production (E & P) Organization and the Products Organization. (J.A. 14). The E & P Organization located, acquired, and produced crude oil and natural gas. (J.A. 14). The Products Organization purchased, transported, and marketed crude oil and natural gas liquids, and manufactured and marketed petroleum and chemical products. (J.A. 14).

Shell's E & P Organization transferred most, but not all, of Shell's OCS crude oil production to the Products Organization in the continental United States. (J.A. 15, 29). This crude oil was either exchanged with other oil companies or was first refined by Shell and then sold or exchanged. (J.A. 29). If the OCS crude oil was refined by Shell, it was commingled with crude oil produced or purchased by Shell from other non-OCS sources so that

the ultimate source of the oil in Shell refined products is indeterminable. (J.A. 19).

Shell's intracompany transfers between its E & P Organization and its Products Organization were internally recorded by Shell as "sales," but no money or other consideration was ever paid. (J.A. 15-16). Shell was a "net purchaser" of crude oil, that is, Shell's total crude oil production from OCS and non-OCS sources was inadequate for Shell's requirements so that Shell purchased the balance of its crude oil needs from other sources, including OCS producers, domestic producers, and foreign producers[1]. (J.A. 16).

Shell's natural gas production in the OCS was purchased by gas transmission companies at the OCS wellhead. (J.A. 34). In contrast to Shell's intracompany crude oil transfers, these third party gas sales in the OCS were for cash. (J.A. 34).

The portion of Shell's unitary business activities in Iowa involved the sale of oil and chemical products which Shell had refined and manufactured outside of Iowa. (J.A. 19). Shell sold crude oil based products in Iowa which it had manufactured from commingled OCS and non-OCS oil. (J.A. 19). The circumstances and detail of Shell's Iowa activities associated with these third party sales are not in the record.

Iowa imposes an income tax upon corporations doing business in Iowa. (Iowa Code § 422.33(2); J.S. App. 95a-96a). The unitary net income of a corporate taxpayer is

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[1]The record does not indicate the amounts of these crude oil purchases from each source.

determined with respect to the corporation's federal taxable income, with some adjustments not relevant to this case. (Iowa Code § 422.35; J.S. App. 96a). The unitary operating net income of a corporation, such as Shell, which does business within and without Iowa is apportioned by a single sales factor formula to impose the tax "only on the portion of the net income reasonably attributable to the trade or business within the state" of Iowa.[2] (J.S. App. 96a).

Iowa's method of apportionment of a single corporation's unitary net income was upheld by this Court, with respect to constitutional attack upon Due Process and Commerce Clause grounds, in *Moorman Manufacturing Company v. Bair*, 437 U.S. 267 (1978). The Iowa Supreme Court has interpreted the Iowa unitary business/formula apportionment method for determining Iowa taxable income as one which "manifests an intent on the part of the legislature to impose a tax on all foreign corporate activities in Iowa that can reasonably be said to produce income." *American Home Products Corporation v. Iowa State Board of Tax Review*, 302 N.W.2d 140, 144 (Iowa 1981); *Internorth, Inc. v. Iowa State Board of Tax Review*, 333 N.W.2d 471, 475 (Iowa 1983).

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[2]Iowa does not impose its tax upon a combined reporting basis upheld by this Court in *Container Corporation of America v. Franchise Tax Board*, 463 U.S. 159 (1983). None of Shell's subsidiaries or affiliates was included in the unitary net income base or in the formula. (J.S. App. 97a-103a). Iowa does include within the scope of its unitary net income base business investment income. *Mobil Oil Corp. v. Vermont Comm'r of Taxes*, 445 U.S. 425 (1980). However, that type of unitary net income is not a subject of this case. Therefore, this case only involves Shell's unitary operating net income earned as a single corporation.

Shell has conceded that the Iowa unitary business/formula apportionment method attributes a reasonable portion of its net income to Iowa as a result of its Iowa activities. (J.S. 7, 12; Shell Brief at 12). There is nothing in the record in this case to support any assumption that the Iowa tax exceeded Shell's profits associated with its Iowa activities.

For 1975 through 1980, Shell filed Iowa income tax returns in which it self-determined its Iowa taxable income under three different methods. (MDA. App. Exhibit N, par. 7). First, for 1975 and 1976, Shell subjected to apportionment to Iowa its total unitary net income by applying a three factor property—payroll—sales formula. Second, for 1977, 1978, and 1979, Shell subjected to apportionment to Iowa part of its unitary net income, after deducting from the unitary net income base a figure purporting to be its "income earned" in the OCS, by applying the Iowa single sales factor formula. Third, for 1980, Shell subjected to apportionment to Iowa its total unitary net income by applying the Iowa single sales factor formula. Of these three methods used by Shell, two did not involve any separate accounting calculation and deduction from the unitary net income base of a purported OCS net income figure.

The Iowa Department of Revenue audited Shell's Iowa income tax returns for 1975 through 1980 and assessed additional tax to Shell. The Revenue Department, in its audit and assessment, restored the purported OCS income figure to the unitary net income base for years 1977, 1978, and 1979. The Revenue Department disallowed the use by Shell of its three factor apportionment formula. The

Revenue Department's audit uniformly apportioned Shell's total unitary operating net income to Iowa by the Iowa sales formula, the numerator of which was Shell's Iowa sales and the denominator of which was Shell's sales everywhere, including in the OCS.

Shell protested the assessment in accordance with the administrative procedures provided by the Revenue Department. An administrative hearing was requested with respect to Shell's assertion that the assessment resulted in the taxation of Shell's income derived from the OCS and was in violation of the Outer Continental Shelf Lands Act (OCSLA), 43 U.S.C. § 1331 *et seq.* (J.A. 48).

Shell's contention that the assessment violated the OCSLA was premised upon its calculation of its alleged OCS net income figure from its oil and gas extraction. In making this OCS calculation, Shell used the posted industry price (value of production) for that grade of oil which was transferred by Shell's E & P Organization to its Products Organization and which was ultimately exchanged or sold outside the OCS. (J.A. 30-31, 45). The calculation also included actual sales prices received from the gas transmission companies for sales of OCS gas in the OCS. (J.A. 34). These posted oil prices and Shell's receipts from gas sales were included by Shell in its determination of its OCS "revenues." (J.A. 36). Shell subtracted from these posted industry oil price "revenues" and from actual gas revenues the expenses which were incurred on and off the Shelf and which it deemed to be functionally related to its OCS production. (J.A. 29-30; MDA. App. Exhibit N, par. 3).

Iowa disputed Shell's calculations as reflecting Shell's OCS net income. (J.A. 29-30, Stip. pars. 22 and 23; MDA. App. Exhibit N, pars. 3-6, 7-10). Indeed, even under a separate accounting theory, Iowa may have been shortchanged by Shell's calculations. (MDA. App. Exhibit N, pars. 3 and 4).

Shell's calculation of its OCS net income figure was done by a separate accounting method that used a functional, not a geographic, approach. (MDA. App. Exhibit N, par. 3). This is obvious because not all expenses attributed by Shell to the OCS, in its separate accounting method, were actually incurred in the area of the OCS. (J.A. 38, lines 17 and 18; 40, lines 23, 24, 26 and 27; 41, line 29). Shell's separate accounting method failed to attribute a portion of its refining and sales expenses which, although incurred outside the OCS, would be functionally related to the OCS. (MDA. App. Exhibit N, pars. 3-4). Obviously, Shell's failure to attribute such refining and sales expenses to the OCS, under generally accepted accounting principles, augments Shell's OCS income figure and decreases the unitary net income base which Shell concedes is apportionable.

Even if Shell had attributed some refining and sales expenses to the OCS, Iowa's position was that the resulting computation would not prove that Iowa taxed any of Shell's OCS net income. (MDA. App. Exhibit N, par. 4). Generally accepted accounting principles are not designed

to ascertain the geographic source of income.[3] (MDA. App. Exhibit N, pars. 9-10).

At the administrative hearing, Shell's evidence basically consisted of its OCS separate accounting method and the attribution of the remainder of its income to Iowa by the Iowa unitary business/formula apportionment method.[4] Shell did not present any evidence with respect to the source of its Iowa profits nor did Shell present any evidence with respect to profits or losses of any other portion of its non-OCS business. Although the record does not reflect the amount of Shell's purchases from other OCS producers, Shell did not purport to exclude such purchases from its cost of goods sold in calculating its so-

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[3]Shell had alleged that its OCS separate accounting income figure was equivalent "of what Shell's net OCS income would be for federal income tax purposes if computed for that segment of Shell's business." (J.A. 29). This allegation was controverted by Iowa. (J.A. 30, 45; MDA. App. Exhibit N, pars. 5 and 6). No tribunal below found that Shell's allegation was true. The Internal Revenue Code does not impose federal income tax upon a mere segment of a corporation's companywide operating income.

[4]Shell had raised an alternative issue of whether the OCSLA required its total OCS "revenues," that is, gross receipts from sales of gas and the gross value of production of oil to be excluded from the unitary net income base without deduction therefrom of any OCS expenses. However, in light of this Court's decision in *First National Bank of Atlanta v. Bartow County Board of Tax Assessors*, 470 U.S. 583 (1985), Shell withdrew its claim for relief in paragraph 47(c) of the Stipulation (J.A. 48-49) in page 1 of its Reply Brief filed in the administrative proceeding. Thus, Shell does not apparently agree with the dissent in *Shell Oil Co. v. Department of Revenue*, 496 So.2d 789, 796 (Fla. 1986), appeal pending 86-1593, which stated that "[t]he proper amount to be excluded is the fair market value of the oil and gas at the wellhead." Shell's withdrawn claim is not an issue before this Court.

called non-OCS income to be apportioned.[5] Therefore, in determining its unitary net income base to be apportioned to Iowa, transactions involving OCS extracted minerals were not wholly ignored by Shell.

The administrative decision concluded that the assessment did not violate the OCSLA. (J.S. App. 74a; par. 17). Significantly, that decision contained a finding that Shell had failed to prove that the assessment taxed its OCS income. (J.S. App. 70a; par. 9).

Shell appealed the administrative decision to the Polk County District Court. The District Court held that the OCSLA prohibited State extraterritorial taxation into the OCS, but did not prohibit a tax "directly attributable to Shell's sales within the State of Iowa." (J.S. App. 33a). The Court found that Shell was not subjected to extraterritorial taxation into the area of the OCS. (J.S. App. 30a-33a).

Shell appealed the District Court's decision to the Iowa Supreme Court. The Iowa Supreme Court rejected Shell's claim that the OCSLA inherently required an exclusion of a separate accounting OCS net income figure from the unitary net income base. (J.S. App. 9a). The Court noted that "Shell has indicated no particular area of congressional policy in the management and control of the OCS lands which is frustrated by the State of Iowa applying a traditional measure of apportionment in order

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[5]For federal and Iowa income tax purposes, gross income is gross receipts less cost of goods sold. Treas. Reg. § 1.61-3(a). Obviously, if cost of goods sold decrease, gross income is augmented. Iowa believes that both sales and purchases of OCS minerals can be reflected in the unitary net income base.

to obtain a valid local nexus for taxation purposes."[6] (J.S. App. 9a). The Court viewed the state tax restrictions in the OCSLA "as a limitation on the authority of states adjacent to the OCS lands to extend legislative jurisdiction to the OCS." (J.S. App. 10a). The Court noted that the inclusion of OCS activities in the unitary business/formula apportionment method "apparently aids in obtaining an accurate measure of the tax to be imposed as a result of Shell's Iowa activities," and that there was an absence in the language or legislative history of the OCSLA that Congress intended to modify the State's ability to tax income attributable to the taxpayer's activities in the taxing State. (J.S. App. 13a). Accordingly, the District Court's decision on the OCS issue was affirmed.

Shell, in its appeal to this Court, has limited its challenge upon OCSLA grounds only to the makeup of the unitary net income base. Even if the Iowa unitary business/formula apportionment method, as applied to Shell, operated to only tax Shell's profits earned in Iowa or even understated Shell's Iowa profits, nevertheless, Shell's position is that it is entitled under the OCSLA to exclude from the unitary net income base a separate accounting OCS net income figure.

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[6]The United States, in its Briefs filed in this case and in the pending Florida case, agrees.

SUMMARY OF ARGUMENT

The Iowa unitary business/formula apportionment method is used to determine the net income attributable to the taxpayer's income producing activities in Iowa. It is used because of the inherent inability of separate accounting to precisely source unitary income to any geographical area. In view of the nature of a unitary business, its net income is not derived from a single "source."

In this case, Shell seeks to exclude a separate accounting OCS net income figure from its unitary net income base and argues that such exclusion is required by the OCSLA which forbids State taxation in the OCS, an area outside of any State. However, the inclusion of Shell's OCS activities in the unitary net income base does not, of itself, result in any extraterritorial taxation by Iowa in terms of projecting State sovereignty or political jurisdiction outside the State. Indeed, the record in this case does not show that the Iowa apportioned tax was imposed upon Shell's profits in excess of those earned in Iowa or in disproportion to Shell's Iowa income producing activities. Moreover, separate accounting for an OCS net income figure does not avoid potential duplicative or overlapping State taxation in the OCS since no uniformity in such accounting exists or is required by OCSLA.

The OCS was declared by this Court in 1950 to be an area of paramount federal political jurisdiction. Even without the OCSLA, no State could extend its sovereignty or political jurisdiction there. As a result of this Court's 1950 decisions, the OCSLA was enacted in 1953 to confirm this federal jurisdiction and to define a body of law for

the Federal Government to use in its administration of the OCS. The language of the OCSLA, in 43 U.S.C. § 1333 (a)(2)(A) and in § 1333(a)(3), which forbids State taxation in the OCS, was intended to clarify that States would have no power to exercise political tax jurisdiction in the OCS. The provisions of the OCSLA do not clearly indicate a facial intent to interfere with State apportioned taxes which include OCS activities in a unitary tax base for the purpose of reasonably evaluating the nexus within the taxing State.

The legislative history of the OCSLA reveals a tug of war between proponents and opponents of State taxation in the OCS in terms of whether States should exercise political jurisdiction there. Proponents wanted permission to extraterritorially tax there. Opponents wanted to send clarifying signals in § 1333(a)(2)(A) and § 1333 (a)(3) that precluded such taxation in the OCS. Ultimately, opponents won out. A key sponsor of the OCSLA explained that § 1333(a)(2)(A) and § 1333(a)(3) had the same meaning with respect to State taxation.

The 1953 OCSLA was amended in 1978. These amendments do not change the scope of the 1953 enactment which precluded extraterritorial exercises of State political tax jurisdiction in the OCS. The 1978 amendments do not address State taxation.

The OCSLA does not create a State tax exemption for a nexus off the Shelf related to OCS production. For example, Iowa could impose a gross receipts tax upon Shell's sales in Iowa involving its OCS and non-OCS production which would be more burdensome than the Iowa net income tax. No sound reason exists to construe the OCSLA

to modify honest State efforts that impose a State net income tax as a result of Shell's nexus in Iowa.

Shell's interpretation of the OCSLA under its separate accounting method would result in a penalty, in the form of higher State taxes, for oil producers whose OCS costs and expenses exceeded OCS revenues and a windfall for those, in the form of lower State taxes, if their OCS revenues exceeded their OCS costs and expenses. Oil producers, in particular the smaller multistate producers, who would have to expend huge sums but initially obtain little or no revenue would have a disincentive in the form of higher State income taxes to invest in OCS leases under Shell's interpretation. Iowa's interpretation avoids this anomaly.

The OCSLA should be construed as precluding the exercise of State political jurisdiction in the OCS, thereby codifying Due Process and Commerce Clause limitations upon extraterritorial taxation. The Federal Government agrees with this construction and is not adversely affected thereby. Based upon that construction, Iowa has not violated the OCSLA in this case merely because Shell's OCS activities are included in the unitary net income base which is subject to apportionment.

In the makeup of the unitary net income base, the OCSLA does not require that a distinction be made between Shell's actual sales outside of Iowa that occur on the Shelf and those which occur off the Shelf. Such a distinction, of itself, does not determine whether Iowa exercised political jurisdiction in the OCS. Therefore, the OCSLA does not dictate that actual OCS sales be excluded from the unitary net income base.

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ARGUMENT

THE OUTER CONTINENTAL SHELF LANDS ACT DOES NOT PRECLUDE THE STATE OF IOWA FROM IMPOSING A TAX UPON THAT PORTION OF A UNITARY NET INCOME BASE WHICH IS REASONABLY ATTRIBUTABLE TO THE TAXPAYER'S INCOME PRODUCING ACTIVITIES IN IOWA.

The question of whether a state tax is validly imposed in an area of exclusive federal jurisdiction has often arisen within the context of State attempts to tax property or activities in a federal area within the boundaries of the taxing State.[7] *See e.g. Humble Pipe Line Co. v. Waggonner,* 376 U.S. 369 (1964); *James v. Dravo Contracting Co.,* 302 U.S. 134 (1937); *Surplus Trading Company v. Cook,* 281 U.S. 647 (1930). That, of course, is not the situation here.

In this case, the area of exclusive federal jurisdiction is located outside the borders of any State. The State tax system under attack does not facially purport to impose a tax upon Shell's income producing activities attributable to the OCS. Rather, Iowa is imposing its tax upon Shell's net income "reasonably attributable to" Shell's "trade

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[7]Many cases have involved Art. I, § 8, cl. 17 of the Constitution. That Clause is not involved here. Shell points out that Congress has the power to limit State taxes and demonstrates instances in which this occurs. (Shell Brief at 17-20). Iowa has never taken issue with the authority of Congress to restrict State taxation in the area of the OCS. This case does not involve the question of whether Congress could require States to deduct an OCS net income figure from a unitary net income base, but rather whether Congress has done so. The OCSLA was enacted under authority of Art. IV, § 3, cl. 2 of the Constitution. H.R.Rep. No. 95-590, 95th Cong. 1st Sess. 54 (1977).

or business within the state" of Iowa. Iowa Code § 422.33 (2) (J.S. App. 96a). Shell concedes that it could not prevail upon Due Process and Commerce Clause Constitutional challenges. (Shell Brief at 12). The issue in the case, as Shell states, is "what is to be included in the income base that is subject to apportionment." (Shell Brief at 9, n. 4). The apportionment formula and the makeup of the factors thereof are not an issue.[8] *Id.*

A. Application of the Iowa Unitary Business/Formula Apportionment Method Was Not Shown by Shell to Constitute Extraterritorial Taxation Into the Area of the OCS.

The provisions of the OCSLA which declare that the OCS is an area of exclusive federal jurisdiction and which preclude State tax laws from application in the Shelf, an area located outside the borders of any State, cannot be considered in a vacuum. The division of income of a unitary multistate business associated with activities in the taxing State is inexorably related to a concrete consideration of whether Iowa has violated the OCSLA.

The unitary business/formula apportionment method in the State income tax field is derived from the unit rule of valuation for ad valorem property tax purposes in-

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[8]Apportionment of net income may not be required with respect to a net income tax imposed upon domiciliaries of the taxing State. Domicile can be an independent nexus for State political jurisdiction to impose such tax, regardless where income is earned. *Lawrence v. State Tax Commission,* 286 U.S. 276 (1932).

volving interstate railroads and utilities.[9] I Hellerstein, *State Taxation, Corporate Income and Franchise Taxes* ¶ 8.5 (1983) at 330; Dexter, *The Unitary Concept in State Income Taxation of Multistate-Multinational Business,* 10 Urban Lawyer 181, 184 (1978). If Shell operated an integrated pipeline system, portions of which were in Iowa, in the OCS, and in non-OCS areas, Iowa, in apportioning value to the State, could reasonably consider the entire system in order to determine the enhanced Iowa value rationally related to the Iowa nexus. Such a property tax system would not be imposed upon OCS property in the area of the OCS in violation of the OCSLA merely because the OCS pipeline portion was included in the apportionable unitary property base. Iowa believes that these same principles should apply in evaluating the Iowa income tax imposed upon Shell's income producing activities in Iowa which are not to be valued merely upon the basis of revenues and costs geographically in the State.

The States, in imposing upon multistate unitary businesses a tax upon their net incomes attributable to business activities in the taxing State, had two choices. First, they could select separate accounting which purports "to identify the precise geographical source of a corporation's profits" in the taxing State. *Moorman Manufacturing*

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[9]In *Pullman Co. v. Richardson,* 261 U.S. 330, 338 (1923), this Court noted the rationale for the unit rule of property valuation:

> "And, if the property be part of a system, and have an assigned value by reason of a connected operation of the whole, it may be taxed according to its value as part of the system, although the other parts be outside the state; in other words, the tax may be made to cover the enhanced value which comes to the property in the state through its organic relation to the system."

Co. v. Bair, 437 U.S. 267, 273 (1978). Second, they could use a unitary business/formula apportionment method "employed as a rough approximation of a corporation's income that is reasonably related to the activities conducted within the taxing State." *Moorman,* 437 U.S. at 273.

States were faced with an impossible task of attempting to make a precise allocation of unitary operating income to any geographical source. The very nature of a unitary business meant that its income was not derived from "a single identifiable source."[10] *Mobil Oil Corp. v. Commissioner of Taxes,* 445 U.S. 425, 438 (1980); *Exxon Corp. v. Wisconsin Dept. of Revenue,* 447 U.S. 207, 222 (1980). Separate accounting "is subject to manipulation and imprecision, and often ignores or captures inadequately the many subtle and largely unquantifiable transfers of value that take place among the components of a single enterprise." *Container Corporation of America v. Franchise Tax Board,* 463 U.S. 159, 164-5 (1983).

Because of these deficiencies in the use of separate accounting, States resorted to formula apportionment to divide the unitary net income base between the taxing State and elsewhere in order to ascertain the value of the income producing activities in the taxing State. Absent a Congressional directive to the contrary, State unitary income/formula apportionment methods need not be uniform. *Container,* 463 U.S. at 167; *Moorman,* 437 U.S. at 280. Because of the inability to precisely allocate a por-

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[10]*See also* discussion in *ASARCO, Inc. v. Idaho State Tax Comm'n,* 458 U.S. 307, 333 (1982) (O'Connor, J., dissenting).

tion of unitary net income to a geographic source, this Court tolerates different State unitary business/formula apportionment methods as long as they do not produce disproportionate amounts of net income subjected to State taxation as a result of instate activities. *Container,* 463 U.S. at 170; *Exxon,* 447 U.S. at 220.

Because separate accounting is flawed, this Court has generally rejected it for components of a unitary business as a benchmark by which to judge whether the State unitary business/formula apportionment method results in extraterritorial taxation in violation of the Due Process and Commerce Clauses. This rejection is in no small part due to the fact that "[a]ccounting practices for income statements may vary considerably according to the problem at hand."[11] *Butler Brothers v. McColgan,* 315 U.S. 501, 507 (1942). Shell's separate accounting which Shell claims is an OCS net income figure should be rejected because "it purports to isolate portions of income received" in the OCS but fails to "account for contributions to income resulting from functional integration, centralization of management, and economies of scale" which constitute

[11]This point is highlighted in the instant case. Shell's separate accounting computation of an OCS net income figure did not attribute any refining or selling expenses to the OCS. Iowa's accountant testified that under generally accepted accounting principles, a portion of such expenses should have been included in the computation. (MDA App. par. 3-4). Obviously, Shell's failure to include a portion of these expenses in its OCS net income figure decreases the remaining unitary net income which Shell concedes that Iowa can apportion. We are not advocating that any form of separate accounting would be appropriate or is required by the OCSLA. We are pointing out that there is no uniform methodology to make a separate accounting of Shell's OCS net income and no way to ensure that the State will not be shortchanged under Shell's interpretation of the OCSLA.

"factors of profitability" that "arise from the operation of the business as a whole." *Mobil Oil,* 445 U.S. at 438; *Exxon,* 447 U.S. at 222. A claim that the Iowa tax constituted extraterritorial taxation into the area of the OCS in violation of Due Process or Commerce Clauses on the grounds that the unitary net income base contained revenues, costs, and expenses located in the OCS would be rejected.[12] *Container Corporation of America v. Franchise Tax Board,* 463 U.S. 159 (1983); *Exxon Corp. v. Wisconsin Dept. of Revenue,* 447 U.S. 207 (1980); *Moorman Manufacturing Co. v. Bair,* 437 U.S. 267 (1978); *Butler Brothers v. McColgan,* 315 U.S. 501 (1942); *Underwood Typewriter Co. v. Chamberlain,* 254 U.S. 113 (1920). These cases demonstrate that the inclusion of revenues, costs, and expenses from outside the taxing State in the unitary net income base does not, of itself, project State sovereignty or political jurisdiction into areas outside the State. Merely because "a tax is contingent upon events brought to pass without a State does not destroy the nexus between such a tax and transactions within a state for which the tax is an exaction." *Wisconsin v. J.C. Penney Co.,* 311 U.S. 435, 445 (1940); *Mobil Oil,* 445 U.S. at 437.

Shell's imperfect separate accounting method for a unitary business is inherently incapable of showing its

[12]When the OCSLA was adopted in 1953, this Court had firmly established that States could require multistate enterprises to use a unitary business/formula apportionment method to ascertain taxable results reasonably related to the taxpayer's activities in the taxing state. *Butler Brothers v. McColgon,* 315 U.S. 501 (1942); *Norfolk & Western Ry. v. North Carolina ex rel. Maxwell,* 297 U.S. 682 (1936); *Kent-Coffey Mfg. Co. v. Maxwell,* 291 U.S. 642 (1934), *aff'd per curiam,* 204 N.C. 365, 168 S.E. 397 (1933); *Bass, Ratcliff & Gretton, Ltd. v. State Tax Commission,* 266 U.S. 271 (1924); *Underwood Typewriter Co. v. Chamberlain,* 254 U.S. 113 (1920).

OCS net income earned within the area of the OCS. Separate accounting, as a purported estimate of income at a "source," is unable to prevent any possible State duplicative or overlapping taxation within the OCS in that it cannot precisely demonstrate where income is earned and there is no uniform separate accounting method that all States would be required to adopt or even that all taxpayers would advocate.[13] *Container,* 463 U.S. at 190-193. "The prevention of duplicative taxation, therefore, would require uniform rules for the division of income." *Moorman,* 437 U.S. at 279. The OCSLA does not contain such uniform rules, no authority is given to the Secretary of Interior or other Federal official or agency to supply such rules, and no Court could adopt such rules. The OCSLA speaks to State tax restrictions which Iowa believes would be the taxable event or nexus that occurred on the OCS. In this case, the nexus, Shell's income producing activities, occurred in Iowa. Accordingly, Shell's discussion in pages 20-24 of its Brief that Iowa taxed its OCS income misses the mark. Shell's separate accounting method cannot even ensure that it will not grab some of its Iowa profits and shelter them from Iowa taxation.

An examination of Exhibit 7 reveals that for years 1975 through 1980, of the huge amounts of Shell unitary operating income, only a tiny part was apportioned to Iowa. (J.A. 51-56). For example, in 1979, Shell earned $1,076,060,336 of unitary net operating income. (J.A. 55).

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[13]Shell's OCS separate accounting method, "as in Alice in Wonderland, operates in a universe of unreality." I Hellerstein, *State Taxation, Corporate Income and Franchise Taxes* ¶ 8.10 at 368 (1983).

Shell's marketing activities in Iowa resulted in sales of $95,272,787. The apportionment resulted in $5,584,753 of Iowa profits earned as a result of Shell's Iowa trade or business activities.[14]

No tribunal below found that Shell had any OCS net income or the amount thereof. The record in the instant case only supports a finding that the Iowa unitary business/formula apportionment method taxed "only the profits earned within the State." *Underwood Typewriter Co. v. Chamberlain,* 254 U.S. 113, 121 (1920). Shell's separate accounting proof relies "upon the sort of formal geographical accounting whose basic theoretical weaknesses justify resort to formula apportionment in the first place." *Container,* 463 U.S. at 181. There is simply no basis in this case to conclude for the year 1979 that the difference between the Iowa apportioned result of $5,584,753 and the Shell result of $4,868,861, which is $715,892, somehow represents Shell's profits on the OCS which Iowa purports to tax. (J.A. 55). No such conclusions can be made for the other years.

Shell is in no position to argue that the difference, in Exhibit 7, between the Iowa apportioned results and the "Net" column is the OCS net income that Iowa is taxing. (J.A. 51-56). In its Iowa Supreme Court Brief, Shell stated that "[i]t has not been Shell's intent or desire in

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[14]Shell's argument that Iowa inevitably taxed a portion of its OCS net income is fundamentally flawed within the context of the record in this case. "Obviously, all sales are not equally profitable." *Moorman,* 437 U.S. at 276. Shell's Iowa sales may have yielded a much higher amount of Shell's profits than the apportioned profits. *Id.* If so, there would be no basis for any claim that Iowa taxed any OCS income. *Id.*

this case to attempt to prove its Iowa income or lack of income or the amount of OCS income Iowa is taxing." (Shell Iowa Supreme Court Brief at 37). This statement and Shell's Exhibit 7 which purports to show Shell's OCS income subjected to Iowa taxation are inconsistent.

B. The State Tax Prohibitions in the OCSLA Should Be Construed to Only Preclude a State From Exercising Political Jurisdiction in the Area of the OCS.

In *United States v. Louisiana,* 339 U.S. 699 (1950), and in *United States v. Texas,* 339 U.S. 707 (1950), this Court held that the OCS was an area of exclusive federal jurisdiction wherein "the Federal Government enjoyed sovereignty and ownership of the seabed and subsoil of the Outer Continental Shelf to the exclusion of adjacent States."[15] *Gulf Offshore Co. v. Mobil Oil Corp.,* 453 U.S.

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[15]The *Louisiana* and *Texas* cases primarily relied upon *United States v. California,* 332 U.S. 19 (1947), in which this Court decided that "California was not the owner of the marginal belt along its coast beyond the low-water mark, and that the Federal Government had primary rights and power over that belt." *United States v. Louisiana,* 446 U.S. 253, 255-256 (1980). In 1953, Congress enacted the Submerged Lands Act, 43 U.S.C. §§ 1301-1315, which overturned the result reached in *United States v. California,* and "in effect, quit claimed to California whatever interest the Federal Government may have had in, and to, all lands and natural resources lying within three geographical miles seaward of the California coastline." *United States v. California,* 447 U.S. 1, 3 (1980). See *also Maryland v. Louisiana,* 451 U.S. 725, 730 (1981). The Submerged Lands Act disclaimed any intent "to affect in any wise the rights of the United States to the natural resources of that portion of the subsoil and seabed of the Continental Shelf lying seaward and outside of the area of lands beneath navigable waters, as defined in section 1301 of this title, all of which natural resources appertain to the United

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473, 479, n. 7 (1981). These decisions "held that under our constitutional arrangement paramount rights to the lands underlying the marginal sea are an incident to national sovereignty and that their control and disposition in the first instance are the business of the Federal Government rather than the States." *United States v. Maine,* 420 U.S. 515, 522 (1975). The *Louisiana* and *Texas* decisions excluded the States from exercising any political jurisdiction in the area of the OCS.

Given the paramount federal jurisdiction and control over the OCS, there was a pressing need for Congressional action because no body of federal law existed for the Government's administration in the Shelf and for the development of its huge potential resources. H.R.Rep.No. 695, 82d Cong. 1st Sess. 6-7 (1951). The enactment of the OCSLA was "the first attempt by the Congress of the United States to deal with the problems, economic and legal, of the outer Continental Shelf as such." S.Rep.No. 411, 83d Cong. 1st Sess. 5 (1953). "[T]he purpose of the OCSLA was to assert the exclusive jurisdiction and control of the Federal Government of the United States over the seabed and subsoil of the outer Continental Shelf and to provide for the development of its vast mineral resources." *Gulf Offshore,* 453 U.S. at 479. The OCSLA was intended to provide "for the orderly development of

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States, and the jurisdiction and control of which by the United States is hereby confirmed." 43 U.S.C. § 1302. The Submerged Lands Act returned to the States political jurisdiction over submerged lands located within their borders. Wessner, *Outer Continental Shelf Revenue Sharing For Coastal States,* 3 Va. J. Nat. Res. Law 131, 139 (1983).

offshore resources." *United States v. Maine*, 420 U.S. at 527.

1. The Language and Legislative History of the OCSLA Do Not Indicate That Congress Intended to Preclude the Inclusion in the Unitary Net Income Base of OCS Activities for the Purpose of Imposing a State Tax Upon Income Producing Activities in the Taxing State.

The OCSLA clearly confirms that the OCS, which is located beyond the borders of any State, is an area of exclusive federal jurisdiction, and, thus, parallels that confirmation made in 43 U.S.C. § 1302 which was part of the Submerged Lands Act. The OCSLA defines the OCS to be "all submerged lands lying seaward and outside of the area of lands beneath navigable waters as defined in section 1301 of this title, and of which the subsoil and seabed appertain to the United States and are subject to its jurisdiction and control." 43 U.S.C. § 1331(a). By reference to 43 U.S.C. § 1301 in § 1331(a), the OCSLA confirms that the OCS is not within any State boundaries. In 43 U.S.C. § 1332(1), it is stated that "the subsoil and seabed of the outer Continental Shelf appertain to the United States and are subject to its jurisdiction, control, and power of disposition as provided in this subchapter." These assertions of federal jurisdiction in the OCS are further addressed in 43 U.S.C. § 1333(a). These provisions, other than § 1302, confirming exclusive federal jurisdiction in the OCS and declaring it to be an area outside the borders of any State, were in the 1953 OCSLA. Christopher, *The Outer Continental Shelf Lands Act: Key to a New Frontier*, 6 Stan.L.Rev. 23, 61-62 (1953). These provisions, of

themselves, would preclude the exercise of State political jurisdiction in the area of the OCS, including State taxes wherein the purported taxable nexus (property or event) was in the OCS. These provisions would not preclude a State tax imposed as a result of a nexus outside of the OCS and in the taxing State, nor do they purport to do so.

Congress was aware "of the close, longstanding relationship between the Shelf and the adjacent States." *Gulf Offshore*, 453 U.S. at 480, n. 7. "This concern manifested itself primarily in the incorporation of the law of adjacent States to fill gaps in federal law." *Id.* Thus, Section 1333(a)(2)(A) authorizes to the extent that "they are applicable and not inconsistent" with federal law the adoption of "the civil and criminal laws of each adjacent State" to fill voids in federal law as substitute federal law. *Rodrigue v. Aetna Casualty & Surety Co.*, 395 U.S. 352, 357-8 (1969); S.Rep.No. 411 at 15-16; Christopher, *The Outer Continental Shelf Lands Act: Key to a New Frontier*, 6 Stan.L.Rev. 23, 37-43 (1953).[16]

Two provisions in the OCSLA relate to State taxation imposed upon property or events in the OCS and are relied upon by Shell in this case. First, § 1333(a)(2)(A) provides that "State taxation laws shall not apply to the outer Continental Shelf." Second, § 1333(a)(3) provides that "[t]he provisions of this section for adoption of State law as the law of the United States shall never be interpreted as a basis for claiming any interest in or jurisdic-

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[16]Mr. Christopher, in his article, discusses each section of the 1953 Act. *Christopher*, at 31-61. The provisions which follow §§ 1331, 1332, and 1333 were largely concerned with leases in the OCS.

tion on behalf of any State for any purpose over the seabed and subsoil of the outer Continental Shelf, or the property and natural resources thereof." Shell concedes that these provisions clarify that States could not impose taxes in the OCS area. (Shell Brief at 26).

The "State taxation laws shall not apply to the outer Continental Shelf" language appears in a statutory provision which sets forth how the Federal Government, in administration and regulation of the Shelf, is empowered to apply not inconsistent adjacent State law as substitute federal law. One who is unfamiliar with the controversies involving the OCS and the legislative history of the OCSLA might conclude, although erroneously, that Congress only intended that federal officials not apply State taxation laws to the OCS. One may wonder why the language is there because the OCS is located outside the borders of any State. Even if one were to correctly surmise that the provision precluded States from levying taxes in the OCS area, the language does not necessarily suggest that OCS activities not be included in a unitary tax base for the purpose of valuing the local nexus in the taxing State, as was done in the instant case. The statute does not say, as does 31 U.S.C. § 3124 with respect to federal obligations, that OCS activities cannot be considered in the computation of a State tax. The language can mean that State tax laws will not apply to the OCS in a jurisdictional sense.

In *Gulf Offshore Co. v. Mobil Oil Corp.,* 453 U.S. 473, 482 (1981), this Court noted that the language in "Section 1333(a)(3) speaks to the geographical boundaries of state sovereignty, because Congress primarily was concerned in enacting OCSLA to assure federal control over the Shelf

and its resources." Section 1333(a)(3) is a clear expression that no State can exercise "political jurisdiction" in the OCS. *Id.* This Court's view of the language in § 1333 (a)(3) is the same as that of Iowa and supports Iowa's position in this case. Section 1333(a)(3) makes plain that it addresses lack of State political jurisdiction on the Shelf. Indeed, on its face, § 1333(a)(3) purports to clarify that the provisions for federal adoption of adjacent State law as substitute federal law do not give States any political jurisdiction in the OCS. S.Rep.No. 411 at 23.

Since the OCSLA does not clearly prevent apportioned State tax schemes which include OCS activities in the unitary base for the purpose of taxing the taxpayer's activities or property in the taxing State, it is appropriate to engage in construction of the statute and, in doing so, to examine the legislative history associated with the OCSLA. The provisions of § 1333(a), except for the "State taxation laws shall not apply to the outer Continental Shelf" language in § 1333(a)(2)(A), were in the Senate bill, S. 1901. *Rodrique,* 395 U.S. at 357-8; S.Rep.No. 411 at 15-16. The State taxation prohibition language in § 1333(a)(2) (A) was in the House bill, H.R. 5134.

The Senate Committee stated that its "collective judgment" concerning State taxation was that § 1333(a)(3) provided that "state taxation laws necessarily are excluded from applicability in this area of exclusive Federal jurisdiction not inside the boundaries of any state." S.Rep.No. 411 at 3. The floor manager of the Senate bill, Senator Cordon, who had the task of explaining the Conference OCSLA bill to the Senate stated that the language "State taxation laws shall not apply to the outer Conti-

nental Shelf" was "unnecessary" and that "it adds nothing to and took nothing from the bill as it passed the Senate," but that "[i]t was requested in a superabundance of caution and was agreed to by the Senate conferees when offered by the House conferees." 99 Cong. Rec. 10471-10472. This Court has stated that "[i]t is the sponsors that we look to when the meaning of the statutory words is in doubt." *NLRB v. Fruit & Vegetable Packers,* 377 U.S. 58, 66 (1964). Senator Cordon's view that the State tax limitations expressed in § 1333(a)(2)(A) and inherent in § 1333(a)(3) have the same effect was never questioned in the Congressional debates and is a reasonable interpretation. Under that interpretation, a State tax does not contravene the OCSLA as long as it is not an exercise of political jurisdiction in the area of the OCS. *Gulf Offshore,* 453 U.S. at 482. A State tax which does not extraterritorially tax in violation of the Due Process Clause and the Commerce Clause is not the exercise of State political jurisdiction in any area outside the taxing State.

The Congressional debates illuminate the dispute between adjacent State Senators and Congressmen who were proponents of extension of State taxing power in terms of political jurisdiction into the OCS and other Senators and Congressmen who were opponents of that type of State taxation. Proponents sought to justify taxation in the OCS by arguing that OCS production would create burdens upon adjacent States who should be compensated by extraterritorial taxation. 99 Cong. Rec. 2505 (Remarks of Rep. Willis); 99 (Cong. Rec. 4884 (Remarks of Rep. Brooks); 99 Cong. Rec. 7261 (Remarks of Sen. Long). Proponents also attempted to justify

OCS taxation by reference to State taxation with respect to public lands located within the boundaries of the taxing State. 99 Cong. Rec. 2509-2510 (Remarks of Rep. Wilson).

Opponents of State taxation in the OCS area were adamant in opposition to extension of State taxation imposed upon property or events in the OCS. 99 Cong. Rec. 2506 (Remarks of Rep. Celler); 99 Cong. Rec. 2511-2512 (Remarks of Rep. Keating); 99 Cong. Rec. 7234 (Remarks of Sen. Cordon). They argued that it was "unconstitutional" to allow State taxation beyond State borders. 99 Cong. Rec. 2506 (Remarks of Rep. Celler). Even those who professed to have no interest in the subject opposed extension of adjacent State taxing power in terms of political jurisdiction into the OCS area as it was beyond the borders of any State.[17] 99 Cong. Rec. 2515 (Remarks of Rep. Smith); 99 Cong. Rec. 2516 (Remarks of Rep. Jonas).

Senator Long, a proponent of State taxation, believed that taxes upon "present sources of revenue" by adjacent States would have to be increased "if employers of these

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[17]Shell argues that Congressional failure to extend the Mineral Leasing Act of 1920, 30 U.S.C. § 189, and the Buck Act of 1940, 4 U.S.C. §§ 105-110, to the OCSLA indicates that Iowa cannot include OCS activities in the unitary net income base. (Shell Brief at 27). But, these statutes involve Congressional permission to States to levy taxes in federal areas within the borders of States, namely, to exercise State political jurisdiction there. Even without these statutes, there should be no inherent prohibition in including activities in a federal area in a unitary tax base for purposes of valuing a tax nexus outside of the federal area. Opposition to extension of the Mineral Leasing Act, § 189, was because the OCS was located outside of any State. 99 Cong. Rec. 2516 (Remarks of Rep. Smith).

workers are subject neither to the State's severance tax, property tax, nor the tax on corporate profits." S.Rep.No. 411 at 67; 99 Cong. Rec. 7261. Senator Long's remarks appear to be directed to the exercise of political jurisdiction in the OCS area, and not to taxation as a result of activities in the taxing state on an apportioned basis, although he did not clearly express that distinction. In any event, this Court, in the interpretation of the OCSLA, has previously rejected the "fears and doubts" of Senator Long, an opponent of the OCSLA, as any "authoritative guide" in the meaning of §1333(a).[18] *Gulf Offshore Co. v. Mobile Oil Corp.*, 453 U.S. 473, 482-3 (1981).

A study of the Congressional debates with respect to State taxation in the OCS shows that they revolved around whether adjacent States would be given permission to extend their sovereignty to levy taxes in that area. Indeed, Representative Keating, a leading foe of State taxation in the OCS and a supporter of the OCSLA, stated that he would "offer an amendment to provide expressly that this power shall not be vested in the States, and affirmatively that State taxation laws shall not apply in the areas of the outer Continental Shelf." 99 Cong. Rec. 2511.

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[18]Shell relies upon Senator Long's remarks concerning a lack of State power to tax corporate profits. (Shell Brief at 31-32). While Senator Long does not clearly indicate whether he objects to the OCSLA because income producing activities there are not considered to be in Louisiana or whether he objects because he felt that the OCSLA would somehow preclude such activities from inclusion in the unitary net income base, this Court has "often cautioned against the danger, when interpreting a statute, of reliance upon the views of its legislative opponents. In their zeal to defeat a bill, they understandably tend to overstate its reach." *NLRB v. Fruit & Vegetable Packers*, 377 U.S. 58, 66 (1964).

Representative Keating believed that "[n]ow is the time we should say or refuse to say that the abutting States shall have this taxing power." 99 Cong. Rec. 2512. Representative Keating's view that Congress should affirmatively provide that State taxation laws have no application in the OCS was in H.R. 5134. 99 Cong. Rec. 4891.

Congress had extensive debates concerning taxation in the OCS. All were in the context of State exercises of political jurisdiction in the OCS, namely, extraterritorial taxation. Ultimately, Congress agreed with the Attorney General that States should not exercise "extraterritorial jurisdiction" in the area of the OCS. S.Rep. No. 411 at 6.

The debates do not even hint that a legitimate local taxable nexus involving OCS minerals would be affected by the OCSLA. On the contrary, the debates indicate that activities in the taxing State associated with OCS resources were not to be immune from State taxation. 99 Cong. Rec. 7254 (Remarks of Sen. Cordon). Shell's separate accounting application is not supported by these debates.

The language of the OCSLA and its legislative history do not indicate that a State's unitary business/formula apportionment method is to be disrupted by a range of separate accounting techniques which do not even avoid potential duplicate or overlapping State taxation in the OCS. There was no discussion of such disruption in the Committee Reports or during the Congressional debates.

The inclusion of any OCS income in the unitary net income base to ascertain Shell's Iowa taxable profits associated with Shell's Iowa income producing activities

impacts upon Shell's OCS operations in a manner which is so "remote and incidental as to justify a federal court in refusing to relieve a taxpayer from a state tax." *S.R.A. Inc. v. Minnesota,* 327 U.S. 558, 562 (1946). Indeed, the principal beneficiary of the OCSLA, the Federal Government, rejects Shell's sweeping interpretation of the Act and, instead, agrees with Iowa's position in this case.[19] U.S. Brief in No. 86-1593 and U.S. Brief in No. 87-984.

It is, thus, clear from this legislative history that both proponents and opponents of State taxation in the OCS wanted to address that subject in the OCSLA. It is also clear that this legislative history discussed State taxation from the standpoint of the exercise of State legislative power in the OCS. The debates did not demean, nor does the language in the OCSLA, the exercise of State taxing power, as in the instant case, which imposes a tax upon a nexus attributable to activities in the taxing State.

In the construction of the OCSLA, the rule of statutory construction whereby this Court is reluctant to disturb the distribution of powers between the states and the Federal Government is apropos. *United States v. Bass,* 404 U.S. 336, 349 (1971); *Apex Hosiery v. Leader,* 310 U.S. 469, 513 (1940). Taxation is a fundamental and his-

[19]Iowa believes that it is reasonable to conclude that the Solicitor General would have filed a Brief in both the Florida and Iowa Shell appeals herein in opposition to the decisions of the Florida Supreme Court and the Iowa Supreme Court if the Federal Government had concluded that those decisions violated the OCSLA and wrongly interfered with paramount federal interests on the Shelf. Where the United States believed that its OCS interests were adversely affected, it has affirmatively acted. *Maryland v. Louisiana,* 451 U.S. 725 (1981).

torical power of a State with respect to events within State borders even if those events are evaluated in part in light of events occurring outside the taxing State. The assumption that the historic powers of States are only superceded by "the clear and manifest purpose" of Congress is to ensure that the federal-state balance "will not be disturbed unintentionally by Congress or unnecessarily by the Court." *Jones v. Rath Packing Co.,* 430 U.S. 519, 525 (1977). If Congress intended to modify the local tax base in Iowa or provide for a "single source" of unitary income in confirming exclusive federal jurisdiction in the OCS, Congress should have "unmistakenly so ordained," *Commonwealth Edison Co. v. Montana,* 453 U.S. 609, 634 (1981), but did not. Therefore, the OCSLA should not be construed to modify State taxes apportioned to activities in the taxing State.

Shell relies upon 1978 amendments to the OCSLA which were enacted "for modernization of the OCS Lands Act." *Watt v. Energy Action Educational Foundation,* 454 U.S. 151, 154 (1981). (Shell Brief at 37-41). In doing so, Shell cites general policy statements to the effect that the 1978 amendments were intended to assure leases in the OCS for fair market value, secure more funds for the Federal Government, provide incentives for oil producers, and reduce dependence upon foreign oil.[20] Shell does not

[20]Shell does not mention the elaborate process since 1978 involving "four distinct statutory stages to developing an offshore oil well." *Secretary of Interior v. California,* 464 U.S. 312, 337 (1984). In this regard, the 1978 amendments made provisions for affected State input regarding "the size, timing, or location of a proposed lease sale." 43 U.S.C. § 1345(a); *Wesner*

(Continued on following page)

suggest that these 1978 amendments somehow expanded the scope of State tax limitations which inhere in the 1953 enactment. Therefore, "it is necessary to look beyond general expressions of 'national policy' to specific federal statutes with which the state law is claimed to conflict." *Commonwealth Edison Co. v. Montana,* 453 U.S. 609, 634 (1981).

The goals of the 1978 Amendments listed by Shell are not incompatible with the Iowa apportioned income tax. The tax does not seek to interfere with Shell's ability to obtain a fair return or the Federal Government's ability to do so. It could hardly be argued by Shell, in this case, that the tax is a disincentive for it to produce in the OCS in light of its long-standing presence there and the fact that it does not generally deduct from its unitary net income base an OCS net income figure with respect to tax returns which it files with most other States. (J.A. 47).

Neither the 1953 OCSLA nor the 1978 Amendments purport to exempt taxable events involving OCS resources wherever they may occur off the Shelf. Iowa could levy a property tax upon all tangible property in the State, including OCS oil or products refined from OCS oil. 99

(Continued from previous page)

at 144-145. Shell does not mention that the 1978 Amendments were also intended to balance OCS development with coastal State environmental concerns. H.R. Conf. Rep. No. 95-1474, 95th Cong.2d Sess 4-5 (1978). Iowa does not suggest that the 1978 amendments lessen the force or scope of the State tax restrictions inherent in the 1953 legislation. However, these Amendments, by granting State input into OCS leasing and showing a concern for State environment, hardly suggest a greater State taxation preemption than originally inherent in the 1953 OCSLA. *See* § 1332(3), (4), and (5), § 1346, and § 1351.

Cong. Rec. 7254 (Remarks of Senator Cordon). Iowa could levy a nondiscriminatory gross receipts tax upon Iowa sales, including Shell's sales of products associated with the OCS. The gross receipts tax would be more "burdensome" than the Iowa income tax associated with Shell's Iowa income producing activities evaluated by inclusion of Shell's entire operating income in the unitary net income base. *Moorman,* 437 U.S. at 280. If Iowa levied the gross receipts tax, Shell could not seriously argue that the tax violated the OCSLA. In the instant case, Iowa is levying a net income tax in which Shell's income producing activities in Iowa revolve around its sales of its petroleum products refined from OCS and non-OCS sources. "[I]t would be an exercise in formalism" to say that the Iowa net income tax levied upon Shell's Iowa income producing activities violated the OCSLA when a more burdensome gross receipts tax levied upon Iowa sales did not. *See id.*

In summary, the language and legislative history of the OCSLA, including the 1978 Amendments, do not support Shell's interpretation that it must exclude a purported OCS net income figure from the unitary net income base. Iowa's inclusion of OCS activities in the unitary base for the purpose of valuing Shell's Iowa activities does not, of itself, amount to the exercise of State political jurisdiction on the Shelf. The OCSLA does not require a State tax dilution of a nexus off the OCS. The interpretation of the OCSLA to the effect that it prohibits State taxes which involve the exercise of State political jurisdiction on the Shelf is supported by the language and legislative history of the OCSLA.

2. Shell's Interpretation of the OCSLA Penalizes Oil Producers Whose OCS Related Costs and Expenses Exceed OCS Revenues.

The OCSLA does not contain any standards to determine an OCS net income figure to be removed from the State unitary net income base. The OCSLA has a uniform application throughout the Nation with respect to State tax prohibitions. Where, as is common, the State unitary net income base is tied to federal taxable income, the OCS net income figure ought not to change from one State to another, but there is no mechanism in the OCSLA to preclude such changes in the various States, due to a lack of uniformity among accounting methods, under Shell's interpretation of the OCSLA. Thus, Shell's interpretation of the OCSLA, in effect, allows each State, in complying with the OCSLA, to select from a multitude of separate accounting techniques to ascertain OCS profits—or losses —to be excluded from the unitary net income base.[21]

Shell concedes that "it is possible for Shell's interpretation of the OCSLA to result in *higher* state taxes." (Shell Brief at 10, n. 7). This point highlights the error of Shell's interpretation of the OCSLA. Shell has argued at length that the 1953 OCSLA enactment and the 1978 amendments were intended to preclude inclusion of OCS activities in the unitary net income base because such make-up of the unitary base results in State taxation which allegedly undermines the Federal Government's jurisdiction, control, and regulation in the area of the OCS. (Shell

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[21]Shell, for the year 1978, computed a greater amount of income attributable to Iowa under its method than Iowa did under the Iowa unitary method. (J.A. 54).

Brief at 20-41). Yet, as Shell concedes, the words "State taxation laws shall not apply to the outer Continental Shelf" and the language in the OCSLA which confirms exclusive federal jurisdiction there will, under Shell's theory, if OCS costs and expenses exceed OCS revenues of an OCS producer, result in *higher* State income taxes.

An OCS producer would have to expend time and money before a productive OCS well was developed. In addition, there was always the risk that an OCS lease might be unproductive. Under these circumstances, it does not make sense to construe the 1953 OCSLA, which precludes State tax jurisdiction in the OCS, to cause an increase in the OCS producer's State income taxes as long as OCS costs and expenses exceed OCS revenues. The record in this case confirms the incurring of large expenditures prior to any substantial extraction of OCS resources. (J.A. 23-29). In determining its various State income taxes, the OCS producer, upon excluding these expenditures from its State unitary tax base, may find that it actually owes the State more tax than if it had been allowed to include its OCS activities in the unitary net income base to determine its State taxable income. We fail to see—and Shell has not explained—what 1953 OCSLA policies were served if the States, in 1953, had adopted Shell's interpretation and, as a result, penalized an OSC producer whose OCS costs and expenses "sourced" to the OCS exceeded OCS "sourced" revenues (including actual and imputed "sales") in the form of higher State taxes. Shell's interpretation penalized the smaller multistate producers who wished to expand into the OCS. Congress did not

clearly dictate these results flowing from Shell's interpretation.

Shell agrees that apportioned income taxes were well established in 1953. (Shell Brief at 32-33). Presumably, oil producers were apportioning their unitary net income base, which would have included revenues, costs, and expenses in OCS and in non-OCS areas. These producers would have been shocked to find that their State income taxes were increased because their OCS costs and expenses exceeded their OCS revenues. The Congressional opponents of State taxation in the OCS would hardly approve of such a higher tax result. There is nothing in the 1978 Amendments which indicate approval of such higher State taxes.

The Iowa unitary business/formula apportionment method does not mistreat any oil producer unless that producer can make a showing, lacking here, that the Iowa tax was disproportionate to the taxpayer's Iowa income producing activities. The Iowa method, unlike Shell's method, does not single out an OCS producer for disparate taxation as compared to other taxpayers or even other producers in non-OCS areas.

3. An Interpretation of the OCSLA to Codify Constitutional Due Process and Commerce Clause Restrictions on Extraterritorial Taxation is Reasonable.

The interpretation of a "statute presents a unique problem in which words derive vitality from the aim and nature of the specific legislation." *Federal Trade Commission v. Bunte Brothers, Inc.*, 312 U.S. 349, 351 (1941). The purpose of the OCSLA was to confirm exclusive federal political jurisdiction in the OCS in light of this Court's decisions on the subject and to define a body of law applicable to the federal administration of the OCS and development of its vast resources. This purpose necessarily excluded State political jurisdiction in the Shelf, but merely including OCS activities in a unitary base for the purpose of valuing the local tax nexus does not interfere with federal jurisdiction on the Shelf. The State tax prohibition language in the OCSLA was intended to clarify affirmatively that States could not impose taxes which constitute the exercise of political jurisdiction in the Shelf. The language in the OCSLA is instantly compatible with an interpretation which bans State taxes that would violate Due Process and Commerce Clauses on extraterritorial grounds. The legislative history underscores such Congressional intent.

There are no clear indications that the OCSLA was intended to modify the unitary net income base with concomitant rewards to some taxpayers and penalties to others depending upon whether their OCS revenues were exceeded by their OCS costs and expenses. In light of the nature of an apportioned State net income tax in which receipts, costs, and expenditures may be incurred all over the world and which produce a unitary net income that is not traceable to a single source, Iowa's interpretation of the OCSLA to the effect of codifying Due Process and Commerce Clause restrictions against State extraterritorial taxation is reasonable. The Federal Government, the main beneficiary of the OCSLA, agrees with this interpretation. U.S. Brief at 5-6, filed in No. 86-1593.

Shell's interpretation of the OCSLA would mean that those States which require taxpayers to ascertain

the State net income base by worldwide combined reporting, *Container Corporation of America v. Franchise Tax Board,* 463 U.S. 159 (1983), would have to carve out an island of OCS net income from worldwide unitary net income. An interpretation producing such a result adds nothing to and is not required by the policies underlying the OCSLA.

C. Inclusion in the Unitary Net Income Base of Actual Sales at OCS Wellheads Does Not, by Itself, Determine Whether the State Unitary Business/Formula Apportionment Method Violates the OCSLA.

Given the inadequacy of Shell's separate accounting to avoid possible duplicative or overlapping State taxation, the impossibility of using that accounting to accurately split a unitary business to "source" income to geographical boundaries, and the goal of apportioned taxes to tax income reasonably attributable to the taxing State, the location of Shell's actual sales outside of Iowa, whether on or off the Shelf, is not controlling in the interpretation of the OCSLA.[22]

Contractual provisions between gas producers and pipeline companies differ. *Maryland v. Louisiana,* 451 U.S. 725, 730 (1981). These differences could result in gas sales with OCS wellhead deliveries excluded from the unitary net income base and gas sales with delivery off

[22]In *Shell Oil Co. v. Department of Revenue,* 496 So.2d 789, 790 (1986), appeal pending No. 86-1593, the Florida Court stated that there was a concession that Shell's actual sales on the OCS must be excluded from the unitary net income base to comply with the OCSLA. Iowa never made such a concession and does not agree that it is necessary for OCSLA compliance.

the Shelf included in the base if the OCSLA was interpreted to make sales location on the OCS a sole determinant for purposes of the makeup of the unitary net income base. The OCSLA does not require a State to modify its unitary net income base as a result of these contractual provisions involving sales of gas extracted in the OCS.

In the makeup of the unitary net income base, it is irrelevant whether the third party sales are in Illinois, New York, or in the OCS. The same is true for deductions and expenditures. The locations outside of Iowa of these components of the unitary net income base do not, of themselves, demonstrate that the Iowa unitary business/formula apportionment method did more than even tax "only the profits earned within the State." *Underwood Typewriter Co. v. Chamberlain,* 254 U.S. 113, 121 (1920). Accordingly, the location of the third party gas sales by Shell, whether on or off the Shelf, does not, of itself, determine whether Iowa is exercising political jurisdiction on the Shelf in violation of the OCSLA. Shell's alternative suggestion for exclusion of OCS third party sales from the unitary net income base should be rejected. (Shell Brief at 44-45).

———o———

CONCLUSION

The judgment of the Supreme Court of Iowa should be affirmed.

Respectfully submitted,

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In the Supreme Court of the United States

OCTOBER TERM, 1988

SHELL OIL COMPANY, APPELLANT

v.

THE IOWA DEPARTMENT OF REVENUE, APPELLEE

On Appeal from the Supreme Court of Iowa

REPLY BRIEF FOR THE APPELLANT

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REPLY BRIEF FOR THE APPELLANT

I.

The central premise of the opposing briefs is that Congress's enactment of the state tax prohibition in the OCSLA did nothing that the Constitution of its own force did not already do. Iowa and the Solicitor General express this proposition in a variety of ways: that the OCSLA merely codified the principle against extraterritorial state taxation that is embodied in the Due Process and Commerce Clauses (see, *e.g.*, Iowa Br. 13, 39; U.S. Am. Br. 5, 16-17, 19, 23); that formula apportionment satisfying constitutionally-required minimum standards necessarily complies with the OCSLA, and therefore that Iowa, by virtue of such apportionment, is taxing only in-state and not OCS income (Iowa Br 11, 19, 21; U.S. Am. Br. 7-11); and that Shell is seeking to use a taxing

method that the Court has held is not required by the Constitution (U.S. Am. Br. 5, 12, 17-18).

As explained in our opening brief (at 42-44), that view of the statute is fundamentally flawed. It treats the OCSLA—which Congress adopted after long and careful consideration—as meaningless surplusage that duplicates existing constitutional requirements. Between 1947 and 1950, the decisions of this Court held that the federal government and not the states had exclusive jurisdiction over off-shore lands and resources. See Shell Br. 3-4. Those decisions plainly and necessarily established that the states could not extend their territorial jurisdiction to the OCS. If, as the states and the Solicitor General now contend, the OCSLA simply codified the constitutional rule against extraterritorial state taxation, it was a useless and purposeless exercise on which Congress wasted a considerable amount of time and effort. According to our opponents' submission, the rules governing state taxation are no different today than they were in 1950, prior to enactment of the OCSLA.

The Solicitor General attempts to avoid this glaring defect by advancing (U.S. Am. Br. 19-20) two purported explanations for the inclusion of the state tax prohibition in the OCSLA. Both of these reduce this important provision to little more than a technical correction, however, and are not supported by the legislative history.

First, the Solicitor General argues that Congress simply sought to ensure that the Buck Act (4 U.S.C. §§ 105 *et seq.*), which consents to otherwise impermissible state taxation in federal enclaves. would not be included among the "laws * * * of the United States" that the OCSLA extended to the outer Continental Shelf (43 U.S.C. § 1333(a)(1)). But the Solicitor General has not cited —and we are not aware of—a single passage in the legislative history that indicates that the state tax prohibition was designed to exclude the Buck Act. On the

contrary, where Congress intended to exclude a particular statute from the scope of 43 U.S.C. § 1333(a)(1)—as it did in the case of the Mineral Leasing Act of 1920, 30 U.S.C. § 189—it said so expressly in Section 1333(a)(1) itself and discussed the question explicitly and at length in the legislative debates (see Shell Br. 29-30 & n.19). In any event, the OCSLA's extension of federal law was intended to assert the exclusive jurisdiction of the United States over the OCS, not to waive it; inclusion of the Buck Act would have subverted that congressional intent.

Second, the Solicitor General argues that Congress merely wanted to make clear that state tax laws were not "borrowed" as surrogate federal law under 43 U.S.C. § 1333(a)(2)(A). But again, the legislative history provides no indication that this was the purpose of the state tax prohibition. More important, common sense suggests that that could not have been its purpose. If state tax laws had been adopted as "the law of the United States" to be "administered and enforced by the appropriate officers and courts of the United States," as Section 1333(a)(2)(A) provides, the revenue from those taxes on the OCS would have gone to the *federal government*, not the states. Yet the debate in Congress over the state tax prohibition was whether the *states* were entitled to raise money for their own treasuries by taxing OCS oil and gas. The Solicitor General's reading of the state tax prohibition renders the statute nonsensical.

Rather than the purposes ascribed by the Solicitor General, it was Congress's intent in enacting the OCSLA to facilitate development of the OCS. See Shell Br. 33-41. Neither Iowa nor the Solicitor General explains how this crucial congressional objective is furthered by their trivializing interpretation of the OCSLA. Quite the opposite, the Solicitor General concedes (U.S. Am. Br. 28-29 n.18) that Congress passed the state tax prohibition

because state taxation would adversely affect the federal government's interest in the OCS leasing program (see also Shell Br. 35-36); while the Solicitor General strives to narrow this congressional concern to extraterritorial state taxes, including unapportioned state income taxes (see U.S. Am. Br. 28), the same policy is equally applicable to apportioned state income taxes. The Solicitor General and the states simply disregard one of the principal guides to the proper construction of the state tax prohibition.[1]

That the Constitution may not proscribe the application of Iowa's apportionment methodology here—a question that Shell has elected not to raise in this case—does not mean that state taxation is consistent with the OCSLA. It is, after all, a statute that is at issue. Formula apportionment may be sufficiently "rational[]" to withstand constitutional scrutiny, but it is at best "a rough approximation of a corporation's income that is reasonably related to the activities conducted within the taxing State" and "generally will not produce a figure that represents the actual profits earned within the State." *Moorman Mfg. Co.* v. *Bair*, 437 U.S. 267, 273 (1978). While "the Court has refused to impose strict constitutional restraints" on formula apportionment "despite this imprecision" (*ibid.*), Congress was not required to be content with the same rough approximation as adequate to promote important national policies in this area of exclusive federal authority. There can be no doubt that Iowa generally imposes a higher tax on Shell by attracting income to the State through the use of formula apportionment. See Shell Br. 10 n.7, 22-24. Such taxation stands as an obstacle to the achievement of Congress's purpose in the OCSLA.

[1] Iowa objects (Br. 13, 36-38) that our interpretation of the OCSLA would not promote OCS development because it could result in higher state taxes in the start-up years of exploration and production when off-shore operations are likely to be unprofitable. This ignores the business reality that, as Congress undoubtedly understood, no company would undertake OCS development unless it expected a profit over the life of the project; an investment of this kind necessarily requires a long-term perspective. Congress's choice of a state tax immunity for OCS income thus accords with the nature of the business decision that an oil company must make. "It is not [the] function [of the courts] to speculate whether * * * one type of tax [immunity], as contrasted with another, is wise. That is a question solely for Congress, acting within its constitutional sphere, to determine." *Federal Land Bank* v. *Bismarck Lumber Co.*, 314 U.S. 95, 104 (1941).

For this reason, the Solicitor General is wrong in contending (U.S. Am. Br. 5, 12) that *Exxon Corp.* v. *Wisconsin Dept. of Revenue*, 447 U.S. 207 (1980), is contrary to our position. That case involved an interpretation of the Constitution, not a federal statute. What is more, the Wisconsin tax expressly required separate accounting rather than apportionment for the income of a unitary oil company's sales of oil and gas to third parties at the wellhead (see 447 U.S. at 226 n.10).

Likewise, *Polar Co.* v. *Andrews*, 375 U.S. 361 (1964), which the Solicitor General discusses at some length (see U.S. Br. 17-18), does not refute our construction of the OCSLA. Once again, *Polar Co.* was a constitutional rather than a statutory decision. In addition, the nature of the tax in *Polar Co.* was fundamentally different from the apportioned income tax in this case.

Polar Co. held that Florida constitutionally could "attach" (375 U.S. at 382) a milk processing tax to the privilege of engaging in the milk business within the State, notwithstanding that some of the milk was ultimately sold and delivered to a federal military installation. See *United States* v. *Mississippi Tax Comm'n*, 412 U.S. 363, 371 (1973) (distinguishing *Polar Co.* on the ground that, "with respect to the initial sale and delivery of the liquor by the suppliers to military facilities located in exclusively federal enclaves, nothing occurs within the State that gives it jurisdiction to regulate the

initial wholesale transaction"). By like reasoning, Iowa (or any other state) could impose a sales or gross receipts tax on the in-state sale of equipment destined for the OCS or an ad valorem property tax on OCS oil stored in the State. See Iowa Br. 34-35. Shell has never contended otherwise. But such taxes, in contrast to Iowa's apportioned income tax, are not levied on Shell's OCS income and do not interfere with Congress's policy of encouraging OCS production by shielding that income from state taxation. It is for that reason that the OCSLA condemns Iowa's income tax as applied in this case.

II.

Both Iowa (Br. 14 n.7) and the Solicitor General (Br. 15 n.10) concede that Congress has the power to immunize income from state taxation in order to promote paramount federal policy. See also *South Carolina* v. *Baker*, 108 S.Ct. 1355, 1364 n.10 (1988). Nevertheless, Iowa argues (Br. 27, 32-33, 39) that, because of the importance of taxation to the states, Congress should be held not to have exercised that power unless it manifestly and unmistakably so provides. Accordingly, while explicitly acknowledging (*id.* at 26) that Shell's reading of the OCSLA is consistent with the statutory language, Iowa urges that such an interpretation should be rejected because "the OCSLA do[es] not *clearly* indicate a *facial intent*" to limit apportioned state income taxes (*id.* at 12 (emphasis added)).[2]

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[2] The Solicitor General's position may reflect the same consideration. President Reagan's Executive Order on "Federalism" directs the Department of Justice to "construe, in regulations and otherwise, a Federal statute to preempt State law only when the statute contains an express preemption provision or there is some other *firm and palpable evidence compelling the conclusion* that the Congress intended preemption of State law, or when the exercise of State authority directly conflicts with the exercise of federal authority under the Federal statute." Exec. Order No. 12,612, 52 Fed. Reg. 41,685, 41,686 (1987) (emphasis added). As we explain in the text, this Court's decisions have never applied that test to federal statutes granting state tax immunity.

As discussed above, the interpretation of the OCSLA we propose is necessary to give meaning to the state tax prohibition and effectuate Congress's policies. Iowa's position, by contrast, renders the state tax prohibition a dead letter. Such a result is impossible to justify under any rule of statutory construction.

But beyond that, slogans such as "[t]axation is a fundamental and historical power of a State" (Iowa Br. 32-33) are of no help in interpreting the OCSLA. It is clear from the text of the statute that Congress was aware of and intended to limit this "fundamental and historical power" of the states. The nature and extent of that congressional limitation must be resolved by reference to the language, history, and policies of the OCSLA, which demonstrate that states may not impose a tax of any sort on OCS income.

Contrary to Iowa's argument, this Court has not applied the kind of special and exceptionally stringent rules of construction to which the State is forced to resort. Rather, the Court has followed its usual course of attempting to determine "the more persuasive construction" of tax immunity statutes under customary principles of interpretation, no matter how "flickering and feeble the light afforded [by Congress] for extracting its meaning." *Offutt Housing Co.* v. *Sarpy County*, 351 U.S. 253, 260 (1956). Indeed, the Court has rejected the argument that Congress's enactment of federal tax immunities is subject to different rules because "the power to tax is basic to the sovereignty of the states." *Dameron* v. *Brodhead*, 345 U.S. 322, 329 (1953) (Douglas, J., dissenting). And in fact the Court has "liberally construed" federal tax immunities where appropriate to the achievement of Congress's purposes. See, *e.g.*, *Porter* v. *Aetna Casualty & Surety Co.*, 370 U.S. 159, 162 (1962).

None of the opposing briefs disputes our contention (Shell Br. 31-32) that the only portion of the OCSLA legislative history that specifically refers to state corporate income taxation is Senator's Long's statements—which were made both in the Committee Report and in floor debate, and to which no disagreement was voiced—that OCS lessees would not be subjected to "the tax on corporate profits." Despite the singular importance of these statements, Iowa (Br. 30) and the Solicitor General (Br. 29) seek to minimize their relevance because they were made in opposition to the OCSLA. However, the views of opponents are "relevant and useful" in construing a statute, "especially where, as here, the proponents of the bill made no response to the opponents' criticisms." *Arizona* v. *California*, 373 U.S. 546, 583 n.85 (1963). See also, *e.g.*, *United States* v. *Sheffield Bd. of Comm'rs*, 435 U.S. 110, 130-131 (1978) (statement of opponent "possesses significant pertinence," particularly since proponents "did not disagree"). No sound canon of construction requires the Court to close its eyes to the most direct evidence in the legislative record of Congress's intent on the very question presented in this case.

Iowa concedes (Br. 30 & n.18) that Senator Long's statements can fairly be understood to prohibit states from including OCS income in the apportionable tax base. It nevertheless asserts that Senator Long's seemingly inclusive remarks, although "not clearly express-[ing] th[is] distinction" (*id.* at 30), simply did not apply to apportioned taxation. There is no support whatsoever for the State's inference, however, and it flies in the face of the fact that Louisiana levied an apportioned corporate income tax and had done so for some two decades at the time the OCSLA was enacted (see Shell Br. 32).

In the same vein, the Solicitor General argues that, because Louisiana law allowed the use of separate accounting in certain circumstances, Senator Long's statement should be read to "refer[] to an *un*apportioned income tax measured by separate accounting" (U.S. Am. Br. 28) rather than to an apportioned tax. This is a perverse and wholly unnatural reading of Senator Long's remarks. First, as the government admits, Louisiana "generally utiliz[ed] an apportionment formula" to tax corporate profits (*ibid.*). Both the Louisiana tax statute (La. Rev. Stat. Ann. § 47:244 (West 1970)) and the decision upon which the government relies (*Texas Co.* v. *Cooper*, 236 La. 380, 107 So.2d 676 (1958)) make clear that separate accounting constituted an exception to the normal apportionment procedure, available only if the party seeking to use separate accounting satisfied the burden under the statute of "show[ing] that the apportionment method produces a manifestly unfair result." Furthermore, a number of large oil companies had refining or other facilities in Louisiana and therefore did not come within the separate-accounting exception cited by the government.[3] It is therefore most unlikely that Senator Long's unqualified statements were meant *sub silentio* to focus exclusively on a narrow exception to Louisiana's method of corporate income taxation and to exclude the State's principal taxing methodology: formula apportionment.[4]

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[3] In fact, it was not until 1958—well after enactment of the OCSLA in 1953—that the Louisiana Supreme Court clarified the circumstances in which the State could require a taxpayer to use separate accounting.

[4] In *Texas Co.* (see 236 La. at 413-414, 107 So.2d at 688), as here (see Shell Br. 7), the income attributable to the production of oil was determined by means of separate accounting based on fair market value. The Louisiana Supreme Court specifically rejected the argument that "no value can be assigned to the oil produced in Louisiana which was, instead of being sold upon the open market, shipped to appellant's self-owned refinery in Texas" (236 La. at 420, 107 So.2d at 690). See Shell Br. 2 & n.1.

The Solicitor General further argues that Senator Long's statements do not relate to formula apportionment because they were "expressly premised on the assumption that a private lessee such as Shell would not be engaging in activities within the taxing State's borders" (U.S. Am. Br. 28), which is the predicate for apportioned taxation. The government's assertion reflects a misreading of Senator Long's remarks. As explained in our opening brief (at 32), Senator Long understood that OCS development would require lessees to have substantial on-shore operations that could be taxed by the states. See S. Rep. No. 411, 83d Cong., 1st Sess. 66-67 (1953) (minority views):

> [T]he Federal Government is receiving the benefit of State services for the support of all activities on shore which are of a larger scope and a greater expense than the actual drilling operation in the sea. Thus we find here a source of wealth * * * which cannot be fully exploited or developed without the benefit of State services from the mainland.
>
> * * * * *
>
> Many of these same services will be provided for the oil company whose base of operations will be necessarily on Louisiana soil. The company will use our highways, will benefit from police protection, and make use of our courts.
>
> None can deny that the furnishing of such services to the thousands of shelf workers, their families, and the companies for which they work will be a heavy financial burden on the State and its subdivisions.

See also 99 Cong. Rec. 7261 (1953) (remarks of Sen. Long). In light of those in-state activities, there is absolutely no reason to assume that Senator Long's statements somehow were intended to exclude apportioned taxation of OCS income. While the Senator noted that states could not impose any tax—a "severance tax," a "property tax," or a "tax on corporate profits" (S. Rep. No. 411 at 67; 99 Cong. Rec. at 7261)—with respect to OCS operations, that hardly suggests an "express[] * * * assumption" (U.S. Am. Br. 28) that OCS lessees would not be engaged in in-state activities that would provide a sufficient nexus for an apportioned income tax.

III.

In large part the position of Iowa (Br. 11, 17, 20 n.13) and the Solicitor General (Br. 13 n.8) amounts to an attack on the concept of separate accounting. If, however, as we have shown, the OCSLA requires that OCS income be excluded from the apportionable income base, separate accounting would be the customary—if not the only—method for making the necessary adjustment.

Moreover, Iowa and the Solicitor General greatly overstate the difficulty of determining OCS income and expenses. Separate accounting is a generally accepted methodology used for a variety of tax (as well as corporate accounting) purposes. For example, the Internal Revenue Code and implementing regulations provide for separate accounting in a number of contexts and prescribe specific rules for its use. See, *e.g.*, 26 U.S.C. §§ 861 *et seq.* and Treas. Reg. § 1.861-8 (tax based on income from sources within or without the United States); 26 U.S.C. § 482 and Treas. Reg. § 1.482-1(d)(1) (adjustment of income and deductions between commonly owned organizations or businesses). Likewise, separate accounting has been widely used by the states: three states currently *require* separate accounting in their corporate tax system (Louisiana, Mississippi, and Oklahoma), and other states previously have done so (see, *e.g.*, *Atlantic Richfield Co.* v. *Alaska*, 705 P.2d 418 (Alaska 1985), appeal dismissed, 474 U.S. 1043 (1986); *Exxon Corp.*, discussed at page 5, *supra*). Indeed, the Solicitor General recognizes as much in his discussion of the Louisiana corporate tax system, see pages 8-9, *supra*. Notwithstanding our opponents' complaints, therefore,

separate accounting is a valid and well-accepted methodology.[5]

This case is not, as some of the *amici* states attempt to portray it, a frontal assault on formula apportionment that "goes to the very heart of the entire unitary method" (Calif. Am. Br. 2) and "would seriously erode the unitary business principle" (N.J. Am. Br. 1). Once again, these overblown assertions ignore the fact that the question presented here turns on a congressional statute, and separate accounting is simply the means of effectuating a specific tax immunity that Congress adopted as a matter of federal policy. Thus, there is no basis for the concern expressed by the states (Calif. Am. Br. 10) that "[i]f [Shell] can use separate accounting to carve out this particular portion [of income], what is to prevent others from using separate accounting to carve out other portions attributable to foreign countries, federal enclaves, Indian lands, and other states, until the entire unitary method is in tatters?" States have the power to prevent the use of separate accounting, unless it is required by the federal Constitution or, as here, a federal statute.

Furthermore, our construction of the OCSLA is not rebutted, as Iowa contends (Br. 20, 36), by the fact that the statute does not contain detailed standards for computing the OCS income that is exempt from state taxation or ensuring that uniform rules are applied by the states. Congress understandably could have left the formulation of such implementing standards to the courts (or the responsible federal agencies), just as it has done

[5] Iowa also criticizes (Br. 7, 18 n.11) Shell's application of separate accounting principles for not attributing certain expenses (such as refining costs) to the OCS. But of course Shell has no refining operations on the OCS, and therefore those costs are irrelevant in determining the net wellhead value of Shell's OCS oil and gas production. In any event, if the Court were to hold that the OCSLA requires that the states exclude income earned on the OCS, Iowa would have the opportunity on remand to challenge Shell's calculations.

under 31 U.S.C. § 3124(a). In addition, even if the determination of OCS income were made by the respective states, the potential for some variation in applying the statute would not be a fatal inconsistency with the OCSLA, provided that each state's methodology furthers rather than impairs the purposes of the Act. And in any event formula apportionment does not avoid the problem of inconsistent state taxing schemes. See *Moorman Mfg. Co.*, 437 U.S. at 276-281. Iowa's solicitude for national uniformity is a flimsy—and an ironic—justification for allowing the 50 states *carte blanche* to include OCS income in the apportionable base on which their income taxes are laid.[6]

[6] The Solicitor General also relies (U.S. Am. Br. 21 n.14) on 43 U.S.C. § 1335(a)(9), which provides for an increase in OCS royalties by the amount of "severance, gross production, or occupation taxes" payable to the state under leases it issued prior to the enactment of the OCSLA. Because the OCSLA unquestionably prohibits these taxes, and because the purpose of Section 1335(a)(9) was to prevent a windfall to existing lessees who were being relieved of state taxes they had expected to pay, the Solicitor General suggests that the absence of apportioned state income taxes from this enumeration means that they are not covered by the OCSLA state tax prohibition. However, given the differences in computing taxes based on net income and taxes (like severance, gross production, and occupation taxes) based solely on the volume of production, it would have been completely infeasible to add to the federal royalty payment the amount of the state income tax that would have been due. Indeed, Section 1335(a)(9) does not refer to unapportioned state income taxes on OCS operations, which Iowa (Br. 30) and the Solicitor General (Br. 28) concede the OCSLA prohibits. Moreover, Section 1335(a)(9) applies only to leases issued by the state prior to the enactment of the OCSLA; for all subsequent leases, the federal royalty is *not* increased by the amount of the prohibited state tax, a result that Congress recognized would inure to the advantage of OCS developers over their competitors operating on the mainland and subject to state taxation. See 99 Cong. Rec. 2575 (1953) (remarks of Rep. Ikard and Rep. Wilson); *id.* at 2577 (remarks of Rep. Brooks); *id.* at 7259 (remarks of Sen. Daniel).

Finally, the OCSLA requires that, at a minimum, the apportionable tax base exclude OCS income earned from sales to third parties on the Shelf. See Shell Br. 44-45; see also page 5, *supra*. The Solicitor General initially agreed with this interpretation (see U.S. Am. Br., *Shell Oil Co.* v. *Florida Dept. of Revenue*, appeal pending, No. 86-1593), but he has now reversed that position and urges the opposite meaning of the statute. The Solicitor General's about-face before this Court within a matter of months certainly casts doubt on the validity of his current construction of the Act. Likewise, in the related *Florida Dept. of Revenue* case, Florida conceded in the state Supreme Court that the OCSLA prohibited inclusion of on-shelf sales in the tax base, but it too now seeks to disavow that concession in the *amicus curiae* brief it has filed here (Fla. Am. Br. 26-30).

As discussed in our reply brief (at 4-6) at the jurisdictional stage in this case, the Solicitor General and Florida cannot escape from their prior positions through a revisionist characterization of the tax imposed on Shell. In addition to the reasons there stated, Florida's repudiation of its earlier concession is especially unconvincing. First, it is logically inconsistent for the State to assert that it uses a one-factor sales formula to determine the excludable income that is attributable to sales on the OCS, but that it uses a three-factor formula of property, payroll, and sales to determine the income attributable to sales within the United States. Moreover, Florida's representation does not in fact accurately describe either the State's statutory and regulatory tax system or what the State did in Shell's tax case; indeed, the State in its brief in the Florida Supreme Court explicitly commented (at 22) that "[t]he OCS, of course, is not outside the United States," and therefore that sales on the OCS would not be excluded from the tax base as a matter of state law. Florida's new-found position appears to be nothing more than a *post hoc* rationalization

advanced by the State's appellate lawyers in an effort to evade their earlier concession as to the meaning of the OCSLA state tax prohibition.

CONCLUSION

For the foregoing reasons and those stated in our opening brief, the judgment of the Supreme Court of Iowa should be reversed.

Respectfully submitted.

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In the Supreme Court of the United States

OCTOBER TERM, 1987

SHELL OIL COMPANY, APPELLANT

v.

IOWA DEPARTMENT OF REVENUE

ON APPEAL FROM THE SUPREME COURT OF IOWA

BRIEF FOR THE UNITED STATES AS AMICUS CURIAE SUPPORTING APPELLEE

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QUESTION PRESENTED

Whether, for purposes of determining the amount of income of a multistate corporation that may be apportioned to any one of the States in which it does business, the Outer Continental Shelf Lands Act, 43 U.S.C. 1333(a), which provides, inter alia, that "State taxation laws shall not apply to the outer Continental Shelf," precludes the inclusion of income earned from the sale of oil and gas extracted from the Outer Continental Shelf in the preapportioned income base of the State's apportionment formula.

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SHELL OIL COMPANY, APPELLANT

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BRIEF FOR THE UNITED STATES AS AMICUS CURIAE SUPPORTING APPELLEE

INTEREST OF THE UNITED STATES

In response to this Court's invitation, the United States filed a brief as amicus curiae in *Shell Oil Co.* v. *Department of Revenue, State of Florida,* appeal pending, No. 86-1593, which raises the question whether the Outer Continental Shelf Lands Act, 43 U.S.C. 1333(a)(2)(A), limits a State's authority to tax an apportioned fraction of income earned from the sale within the United States of oil extracted from the Outer Continental Shelf. We subsequently filed a brief as amicus curiae at the jurisdictional stage in this case, which raises essentially the same issue.

STATEMENT

1. Appellant Shell Oil Company (Shell) is a Delaware corporation engaged in the unitary business of exploring for, refining and marketing oil and gas products (J.S. App. 7a, 16a-17a). Shell conducts its production activities within various States and on the Outer Continental Shelf (OCS) (*id.* at 20a, 48a). Shell sells all natural gas produced

on the OCS at the platform on OCS lands (*id.* at 7a-8a). In contrast, most of Shell's crude oil is transferred off OCS lands to pipelines for transport to the continental United States, where it is delivered to refineries or other manufacturing facilities (*id.* at 8a, 20a, 25a). Shell's principal business in Iowa during the years at issue consisted of marketing oil and chemical products that had been refined and manufactured outside Iowa (*id.* at 8a, 17a-18a).

The State of Iowa imposes an income tax, administered by appellee Iowa Department of Revenue, on the apportioned share of "net income" that is "reasonably attributable to the trade or business within the state" (J.S. App. 8a, 95a-96a); see Iowa Code Ann. § 422.33(1), (2) and (2)(b)(4) (West Supp. 1988)). Under Iowa law, a corporation's "net income" is its taxable income for federal income tax purposes, as adjusted pursuant to Section 422.35 of the Iowa Code (J.S. App. 96a; see Iowa Code Ann. § 422.35 (West Supp. 1988)). The amount of total net income attributed to business conducted in Iowa is determined under a one-factor formula, which is based on the ratio of sales made in Iowa to gross sales everywhere (see *id.* § 422.33(2)(b)(4); J.S. App. 27a):

$$\frac{\text{Iowa Gross Sales}}{\text{Everywhere Gross Sales}} \times \text{Federal Taxable Income Adjusted Per Iowa Law} = \text{Iowa Income}$$

In computing the portion of its net income attributable to business done within Iowa for the years 1978 through 1980, Shell excluded from the net income subject to apportionment the amount it determined to represent actual or deemed earnings from OCS oil and gas production (J.S. 8; J.S. App. 27a). For oil and gas sold to third parties on the OCS, Shell excluded its gross receipts from those sales, less related costs and expenses. Where the oil was simply

transferred to pipelines for transportation to shore, the amount excluded consisted of the wellhead fair market value of the oil, less related costs and expenses (J.S. App. 21a, 27a; J.S. 2 n.1, 8 n.4). The result was the following adjustment of Iowa's one-factor formula:

$$\frac{\text{Iowa Gross Sales}}{\text{Total Gross Sales less OCS Gross "Sales" actually made and wellhead fair market value of oil transported to shore}} \times \text{Non OCS taxable Income} = \text{Iowa Income}$$

The Iowa Department of Revenue rejected this modification to Iowa's apportionment formula, and issued a notice of assessment computing Shell's Iowa income in accordance with the apportionment formula established by Iowa law (J.S. App. 70a).

2. Shell contested the increase in tax in a hearing before the Iowa Department of Revenue. Shell contended that under the Outer Continental Shelf Lands Act (OCSLA), 43 U.S.C. 1333(a)(2)(A), it was entitled to exclude OCS revenues from its preapportionment net income base. The hearing officer rejected Shell's contention on the ground that the inclusion in the apportionment formula of income Shell attributed to its OCS activities did not itself entail an application of Iowa's tax law to the OCS in contravention of OCSLA (J.S. App. 72a-74a, 37a).

3. The Iowa District Court for Polk County affirmed the final order of the hearing officer (J.S. App. 15a-35a). The district court held that "[n]othing in the OCSLA or its legislative history can be construed as prohibiting states, either adjacent or inland, from fairly apportioning * * * income derived from sales in the taxing state." Instead, the court concluded (J.S. App. 31a-32a, 33a), "OCSLA was primarily concerned with defining territorial jurisdiction and to quiet title as between adjacent states and the federal government as to submerged lands" and, hence, "OCSLA prohibits extraterritorial taxation of the OCS by both in-

land and adjacent states." Iowa's tax does not run afoul of that prohibition, the court explained (*id.* at 32a-33a), because its "apportionment scheme does not tax income derived by Shell solely from the OCS. Rather, Iowa's indirect taxation of Shell's OCS income is directly attributable to Shell's sales within the State of Iowa."

4. The Iowa Supreme Court affirmed (J.S. App. 1a-14a). The court found (*id.* at 13a (footnote omitted)) that "[t]he inclusion of OCS revenues in gross sales for purposes of applying the statutory apportionment formula * * * apparently aids in obtaining an accurate measure of the tax to be imposed as a result of Shell's Iowa activities." The court concluded (*ibid.*) that it could not "attribute to Congress an intent to impede this legitimate goal in the absence of some compelling indication that such was its intention in passing the OCSLA" and that it could not "divine any such intention from either the legislative history or language of the Act." "Shell's argument fails to indicate how the impact of applying the apportionment formula detracts in any identifiable way from Congressional policy relating to OCS lands" (*ibid.*).[1]

SUMMARY OF ARGUMENT

Shell contends that the Outer Continental Shelf Lands Act (OCSLA) limits state authority to tax income earned

[1] The state supreme court also noted (J.S. App. 10a) that the facts of this case differ from those in *Shell Oil Co.* v. *Department of Revenue*, 496 So.2d 789 (Fla. 1986), appeal pending, No. 86-1593, because the "Florida revenue officials had excluded from their apportionment formula that portion of Shell's gross revenues which were derived from sales made on OCS lands," while "Iowa has apparently included in its gross apportionment formula some revenues derived by Shell from the sale of natural gas at the platform on the OCS" (J.S. App. 10a). The state court concluded, however, that Florida's practice was not compelled by OCSLA.

from activities occurring on the OCS beyond those restrictions imposed on extraterritorial taxation by the Due Process and Commerce Clauses. In particular, Shell argues that OCSLA requires a State to do the very thing that this Court ruled in *Exxon Corp.* v. *Wisconsin Dep't of Revenue*, 447 U.S. 207, 226-229 (1980), that the Due Process and Commerce Clauses do *not* require where the State is applying its apportionment formula to determine the income attributable to the in-state marketing of oil and gas that was produced in another State: exclude from its apportionable tax base the wellhead value of the crude oil and gas.

OCSLA's language, structure, and legislative history show, however, that Congress simply intended to bar any State from subjecting activities on the OCS to taxation as if the OCS were located within the State's borders. A State, therefore, may not impose a severance, production, property, or sales tax on Shell's activities on the OCS. Nor may a State, in determining the amount of Shell's total income that is reasonably attributable to Shell's in-state activities for apportionment purposes, transgress Due Process and Commerce Clause limitations on extraterritorial taxation. OCSLA does not, however, further limit the methods by which a State may utilize its apportionment formula to determine the portion of a unitary business's income that may fairly be attributed to the activities of the business occurring within the taxing State's borders.

Contrary to Shell's claim, the language of OCSLA does not suggest otherwise. First, there is no merit to Shell's submission that Congress's description of the OCS as "an area of exclusive Federal jurisdiction" (43 U.S.C. 1333(a)(1)) evinces congressional intent to preempt the utilization of state apportionment formulas, such as Iowa's, that otherwise comport with the constitutional prohibition on extraterritorial taxation. The same Due Process and Commerce Clause limitations on extraterri-

torial taxation apply whether a unitary business is conducting some of its activities in another State or in an area of exclusive federal jurisdiction (such as the District of Columbia). In both circumstances, a State may consider the business's activities occurring in another jurisdiction in determining the amount of the business's total income that can be fairly attributed to activities occurring within the taxing State's jurisdiction.

Nor is Shell's preemption claim supported by either Section 1333(a)(2), which prohibits the application of "State taxation laws * * * to the OCS," or by Section 1333(a)(3), which disclaims any intention in Section 1333 of conferring on any State "a basis for claiming any interest in or jurisdiction * * * over the [OCS]." Both provisions simply make plain that state taxation laws were not among the laws of States adjacent to the OCS that, pursuant to Section 1333(a)(1), Congress intended to make applicable to that area. Neither provision evinces congressional intent to supplement Due Process and Commerce Clause restrictions on extraterritorial taxation of the OCS.

Finally, the legislative history of OCSLA supports our reading of the statutory language. Whether the laws of the adjacent States, including their power of taxation, should extend to the OCS as they previously had purported to do, was a central focus of congressional concern and debate. Those opposing such state taxation ultimately prevailed and, to that end, added the statutory language upon which Shell relies. Congress, however, never expressed any intent to reduce exposure of private lessees (such as Shell) to state income tax based, as required by the Due Process and Commerce Clauses, on income attributable to their in-state business activities.

ARGUMENT

THE OUTER CONTINENTAL SHELF LANDS ACT DOES NOT REQUIRE IOWA TO EXCLUDE FROM THE PREAPPORTIONED BASE OF ITS APPORTIONMENT FORMULA INCOME DERIVED FROM OIL AND GAS EXTRACTED FROM THE OUTER CONTINENTAL SHELF

Shell's claim that Iowa's apportioned income tax violates the Outer Continental Shelf Lands Act (OCSLA) is somewhat paradoxical. Shell does not contend that Iowa's tax offends the Due Process and Commerce Clauses, which prevent Iowa from taxing income attributable to out-of-state activities. Yet Shell's preemption claim is that Iowa taxes income "attributable to the extraction of the resource on the OCS" (Br. 2 n.1; see *id.* at 16 n.9, 22-24). Shell's complaint is premised on the proposition that Congress established a more stringent ban on extraterritorial taxation than that generally imposed by the Due Process and Commerce Clauses. In particular, Shell claims that OCSLA, unlike the Due Process and Commerce Clauses, dictates that the wellhead value of OCS oil and gas be specifically allocated to the OCS and not included in any State's preapportioned income base.

We believe that the Iowa Supreme Court correctly rejected Shell's preemption claim. Nothing in OCSLA's statutory language, structure, or legislative history suggests Congress concluded that the Due Process and Commerce Clauses would not adequately prevent extraterritorial taxation of activities on the OCS. Specifically, there is no merit to Shell's claim that Congress decided that the apportionment formula method of state income taxation would lead to excessive taxation and, for that reason, decided to require that States "back out" of their preapportioned income tax bases the wellhead value of OCS products, and allocate that amount to the OCS. The decision of the Iowa Supreme Court therefore should be affirmed.

A. Shell Can Maintain Its Claim That Iowa Impermissibly Taxes OCS Income Only If OCSLA Imposes More Stringent Restrictions On Extraterritorial Taxation Than Those Imposed By The Due Process And Commerce Clauses

1. Shell's preemption claim is premised on a misapprehension of the Due Process and Commerce Clause limitations on extraterritorial state taxation. Shell concedes (Br. 12) that Iowa's tax does not violate the Due Process and Commerce Clauses. Shell argues (*id.* at 22-24) instead that Iowa's tax violates OCSLA by taxing "income Shell earned from the extraction of oil and gas from the OCS," which Shell defines (*id.* at 2 n.1) as "the portion of income from the sale of OCS oil and gas that is attributable to the extraction of the resources on the OCS." Shell's specific claim is that Iowa must exclude from its apportionable tax base the wellhead value of OCS oil and gas—"the increment of income that represents the net value at the wellhead (*i.e.*, fair market value less related costs and expenses) of the OCS production" (*ibid.*)—which must instead be allocated, for income tax purposes, exclusively to the OCS itself.

The premise of Shell's preemption claim—that Iowa is taxing income "attributable" to the OCS—cannot readily be squared, however, with its concession that Iowa's tax is consistent with the Due Process and Commerce Clauses. An apportioned state income tax that conforms to the requirements of those Clauses taxes only income "attributable" to in-state activities.[2] Hence, Shell is flatly

[2] "Under both the Due Process and the Commerce Clauses of the Constitution, a State may not, when imposing an income-based tax, 'tax value earned outside its borders.' " *Container Corp. of America* v. *Franchise Tax Bd.*, 463 U.S. 159, 164 (1983) (quoting *ASARCO, Inc.* v. *Idaho State Tax Comm'n*, 458 U.S. 307, 315 (1982)); see P. Hartman, *Federal Limitations on State and Local Taxation* § 2.3, at 20 (1981). "It has long been settled that 'the entire net income of a

wrong in suggesting (Br. 24) that although a State may constitutionally "value in-state transactions under * * * an apportionment theory, there can be no doubt that in doing so the State has taxed" income of Shell that is "attributable" to the OCS. Shell ignores the fact that the very purpose of the function performed by a valid apportionment methodology is to determine the portion of a unitary business's income that is attributable to the business's *in-state* activities, which, as Shell properly concedes,[3] may b

corporation, generated by interstate as well as intrastate activities, may be fairly apportioned among the States for tax purposes by formulas utilizing in-state aspects of interstate affairs' " without offending the Due Process and Commerce Clauses. *Exxon Corp.* v. *Wisconsin Dep't of Revenue*, 447 U.S. 207, 219 (1980) (quoting *Northwestern States Portland Cement Co.* v. *Minnesota*, 358 U.S. 450, 460 (1959); see *Underwood Typewriter Co.* v. *Chamberlain*, 254 U.S. 113 (1920). A common way for a State to calculate the amount of a multistate business's income that is fairly attributable to the State is the formula-apportionment method. Under this method, a State begins with company-wide income (from some or all sources) and multiplies that figure by a fraction used to approximate the local share of business. This Court has approved the general use of the common three-factor fraction (receipts, wages, and real and tangible property) (see *Container Corp. of America* v. *Franchise Tax Bd.*, 463 U.S. at 170) and has required taxpayers complaining that unfair apportionment has resulted in the taxation of extraterritorial values, in violation of the Due Process and Commerce Clauses, to show "by 'clear and cogent evidence' that the income *attributed* to the State is in fact 'out of all appropriate proportions to the business transacted * * * in that State.' " *Moorman Mfg.* v. *Bair*, 437 U.S. 267, 274 (1978) (citation omitted; emphasis in original); see *Exxon Corp.* v. *Wisconsin Dep't of Revenue*, 447 U.S. at 220; *Butler Bros.* v. *McColgan*, 315 U.S. 501, 507 (1942); see also *Hans Rees' Sons* v. *North Carolina ex rel. Maxwell*, 283 U.S. 123 (1931) (State may not tax 66-85% of income where only 17% is properly attributed to the State).

[3] See Shell Br. 16 n.9 ("States are free, of course, to tax the portion of a taxpayer's income that is attributable to the subsequent transporting, processing, and marketing of OCS production.").

taxed by a State.[4]

Not surprisingly, Shell lacks any persuasive support for its contrary view that the Due Process and Commerce Clauses allow a state to tax income that is not attributable to in-state activities. The decision of this Court upon which Shell principally relies, *Exxon Corp.* v. *Wisconsin Dep't of Revenue*, 447 U.S. 207 (1980), does not stand for that proposition. Contrary to Shell's intimation (Br. 23), the Court did not indicate in *Exxon Corp.* that a State could, consistent with the Due Process and Commerce Clauses, tax income attributable to the out-of-state exploration and production of oil and gas.

The statement in the Court's opinion upon which Shell relies (Br. 23, citing 447 U.S. at 210), more fully quoted, describes an issue presented in the case: "whether the Due Process Clause permits a State to subject to taxation under its statutory apportionment formula income derived from the extraction of oil and gas located outside the State which is used by the refining department of the taxpayer, or whether the State is required to allocate such income to the situs State." [5] Contrary to Shell's assumption, however, "subject[ing]" income "derived from the extraction

[4] Instead of the three-factor formula commonly used by other States (see note 2, *supra*), Iowa uses a single factor formula, which determines the amount of a unitary business's nationwide income attributable to Iowa by multiplying the business's federal taxable income (with certain adjustments not relevant to this case) by a fraction reflecting the proportion of its total sales that are within Iowa. This Court rejected a Due Process and Commerce Clause challenge to Iowa's apportionment formula in *Moorman Mfg.* v. *Bair, supra.*

[5] In *Exxon Corp.*, the Court rejected the taxpayer's contention "that at least the income derived from exploration and production must be treated as situs income and allocated to the situs State rather than included in the apportionment statute." See 447 U.S. at 225-226 (footnote omitted); pages 12-13 & note 18, *infra.*

of oil and gas located outside the State" to a "statutory apportionment formula" is *not* tantamount to taxing that income.[6] Income that is included in the apportionable tax base is not, by virtue of that inclusion, "taxed" by the State; only the fraction of total income that the apportionment formula determines (by multiplying the tax base by the apportionment fraction) to be attributable to the taxing State's jurisdiction can, consistent with the Due Process and Commerce Clauses, ultimately be taxed by the State.[7]

[6] Shell fails to distinguish between income that is "attributable" for tax purposes to out-of-state activities and income that is "derived" from such activities. The latter may be considered in determining the proportion of total income attributable to in-state activities without offending constitutional barriers to extraterritorial taxation. Cf. *Mobil Oil Corp.* v. *Commissioner of Taxes*, 445 U.S. 425, 440 (1980) ("Mobil's business entails numerous 'taxable events' that occur outside Vermont. That fact alone does not prevent the State from including income earned from those events in the preapportionment tax base.").

[7] Shell's misapprehension of the purpose of a valid apportionment formula infects its entire presentation. For instance, Shell wrongly asserts (Br. 14-15; see *id.* at 20-21) that "[b]y arguing that each state is free to tax a proportionate part of Shell's OCS income, Iowa would allow the states collectively to do what it concedes no State can do individually: levy an income tax on the full measure of Shell's OCS production." Shell forgets that because certain activities, such as sales (see Shell's Br. 44), occur on the OCS itself, the sum of all of the States' apportionment fractions should (in theory) be *less* than, and not equal to, "one" (since in each case the denominator of the apportionment fraction will include sales occuring in all 50 states plus the OCS, while the numerator will reflect the sales in each of the states). Hence, contrary to Shell's claim, under Iowa's theory, the States would not "collectively" be "levy[ing] an income tax on the full measure of Shell's OCS production."

Equally unpersuasive is Shell's suggestion (Br. 21) that, under Iowa's view, if "Shell does business and sells its OCS oil only in [Iowa], * * * 100% of Shell's OCS oil income would be apportioned

2. Hence, Shell can prevail in this case only by showing that Congress intended in OCSLA to supplement the restrictions on extraterritorial taxation imposed by the Due Process and Commerce Clauses, requiring those taxes to meet still more stringent restrictions insofar as they touch OCS activities. Indeed, Shell must establish that Congress required in OCSLA that States do the very thing that this Court ruled in *Exxon Corp.* v. *Wisconsin Dep't of Revenue,* 447 U.S. at 226-229, that the Due Process and Commerce Clauses do *not* require where one State is ap-

to—and taxed by—Iowa under its sales-factor apportionment formula." Shell's hypothetical does not necessarily mean that it would be subjected to double taxation. In any event, Shell ignores the fact that this Court has upheld Iowa's single-factor formula under the Due Process and Commerce Clauses—but only as "presumptively valid." See *Moorman Mfg.* v. *Bair*, 437 U.S. at 273. Those Clauses forbid the *application* of Iowa's apportionment formula where it would result in "income attributed to the State '* * * out of appropriate proportions to the business transacted * * * in that State,' [*Hans Rees' Sons*], 283 U.S., at 135, or * * * 'a grossly distorted result,' [*Norfolk & W. Ry.* v. *Missouri State Tax Comm'n*, 390 U.S. 317, 326 (1968)]" (437 U.S. at 274). As this Court recognized in *Moorman Mfg.* v. *Bair, supra*, under Iowa's law, "[i]f the taxpayer believes that application of [Iowa's apportionment] formula subjects it to taxation on a greater portion of its net income than is 'reasonably attributable' to business within the State, it may file a statement of objections and submit an alternative method of apportionment. If the evidence submitted by the taxpayer persuades the Director of Revenue that the statute is 'inapplicable and inequitable' as applied to it, he may recalculate the corporation's taxable income" (437 U.S. at 270; see Iowa Code Ann. § 422.33(3) (West Supp. 1988)). In any event, the focus of Shell's argument is misdirected. The basis for its complaint that Iowa might attribute to itself "100% of Shell's OCS income" is the peculiar nature of Iowa's single-factor sales formula. Hence, the argument does not support Shell's contention that Congress intended in OCSLA to require all States, including those utilizing the more common three-factor formula (see note 2, *supra*), to exclude the wellhead value of OCS oil and gas from their preapportioned income bases.

plying its apportionment formula to determine the income attributable to in-state marketing of oil and gas produced in another State: utilize "separate accounting" to exclude from their apportionable tax bases the wellhead value of the crude oil and gas.[8]

As described below, we do not believe that Congress intended in OCSLA to depart from those constitutional principles in forbidding extraterritorial state taxation of the OCS. We are not persuaded that Congress intended to require that a precise amount of Shell's income (the OCS wellhead value) be excluded from a State's preapportioned

[8] In *Exxon Corp.*, which involved oil production in states other than the taxing state rather than on the OCS, the Court considered, and squarely rejected, a contention identical to Shell's but based on the Due Process and Commerce Clauses. The taxpayer there argued that where, as in this case (see J.A. 13-14, 19, 20), the activities of a unitary business engaged in the exploration, production, and marketing of oil and gas are essentially confined to marketing in the taxing State, "income derived from exploration and production must be treated as situs income and allocated to the situs State rather than included in the apportionment statute" (447 U.S. at 225-226 (footnote omitted)). The Court found (*id.* at 229) that "there is nothing 'talismanic' about the concept of situs for income from exploration and production of crude oil and gas." "The geographic location of such raw materials does not alter the fact that such income is part of the unitary business of the interstate enterprise and is subject to fair apportionment among all States to which there is a sufficient nexus with the interstate activities of the business" (*id.* at 230). This Court, moreover, has repeatedly observed that apportionment formulas are justified by the "basic theoretical weaknesses" of formal geographical or functional accounting. See, *e.g.*, *Container Corp. of America* v. *Franchise Tax Bd.*, 463 U.S. at 181. As this Court has pointed out, separate accounting is subject to "imprecision" and "manipulation" and it "often ignores or captures inadequately the many subtle and largely unquantifiable transfers of value that take place among the components of a single enterprise" (*id.* at 164-165; see *Mobil Oil Corp.* v. *Commissioner of Taxes*, 445 U.S. at 438).

income base and, in effect, be placed beyond the reach of all state income taxation by being allocated to the OCS for state income tax purposes.[9]

B. The Language Of OCSLA Does Not Bar Iowa From Determining The Portion Of Shell's Income That Is Fairly Attributable To Iowa By Utilizing An Apportionment Formula That Comports With Due Process and Commerce Clause Restrictions On Extraterritorial Taxation.

Shell's claim (Br. 24-28) that the "plain language" of OCSLA preempts Iowa's tax is based on the terms of 43 U.S.C. 1333(a). The three subparagraphs of that provi-

[9] Shell alternatively argues (Br. 44-45) that, at a minimum, OCSLA "bar[s] state taxation of income earned from OCS production that is sold to a third party on the Shelf itself." We perceive no ground for such a distinction in OCSLA. As Shell previously recognized in its Jurisdictional Statement, "[n]othing in the language of the OCSLA or its purposes turns on the location of the ultimate sale of OCS production" (J.S. 23). Of course, whether the Due Process and Commerce Clauses restrict the inclusion of such income in the preapportioned tax base is a different matter. Those Clauses would require exclusion if Shell could prove that " 'the income was earned in the course of activities unrelated to the sale of petroleum products in that State.' " *Exxon Corp.* v. *Wisconsin Dep't of Revenue*, 447 U.S. at 223 (quoting *Mobil Oil Corp.* v. *Commissioner of Taxes*, 445 U.S. at 439). Shell, however, would have difficulty maintaining that argument for two reasons. First, Shell has already conceded that it is a "unitary business" (see J.A. 13-14, 20). See *Container Corp. of America* v. *Franchise Tax Bd., supra.* In addition, Iowa's apportionment formula should already effectively exclude the income from OCS sales from the income attributable to (and ultimately taxed by) Iowa, because the apportionment fraction's denominator (sales everywhere) exceeds the numerator (sales in Iowa) by at least the amount of sales on the OCS itself. In any event, because Shell relies exclusively on OCSLA and does not claim that the Due Process and Commerce Clauses are themselves offended by Iowa's tax, this case, like *Exxon Corp.* v. *Wisconsin Dep't of Revenue*, 447 U.S. at 225-226 n.10, 227 n.11, does not provide an occasion to reach that distinct constitutional issue.

sion, however, do not even address, let alone support, Shell's cause.[10]

1. Shell principally relies (Br. 24-26) on the language of Section 1333(a)(1), which provides that "[t]he Constitution and laws and civil and political jurisdiction of the United States are extended to the * * * [OCS] * * * to the same extent as if the [OCS] were an area of exclusive Federal jurisdiction located within a State" (43 U.S.C. 1333(a)(1)). But, contrary to Shell's claim (Br. 24-25), it does not follow from that statutory language that Congress necessarily intended to preempt Iowa's apportioned net income tax on Shell.

[10] Shell's threshold argument (Br. 17-20) that Congress has the power to limit state taxation and has done so in other federal statutes to promote federal policies, while correct, is unavailing here. The question in this case is what Congress intended to accomplish in OCSLA, not what Congress had the power to do, or what Congress has chosen to do in wholly unrelated statutory contexts. Indeed, the other statutory provisions cited by Shell tend to undermine more than support Shell's argument that Congress intended in OCSLA to supplement the prohibition on extraterritorial taxation imposed by the Due Process and Commerce Clauses. For instance, the language of 31 U.S.C. 3124(a) (emphasis added), cited by Shell (Br. 17-18), contrasts sharply with the language in OCSLA upon which Shell relies. Section 3124(a), which prohibits States from taxing federal obligations or the interest thereon, specifically forbids (with certain exceptions) any form of state taxation "that would require the obligation, the interest on the obligation, or both, *to be considered in computing a tax* * * * " (emphasis added). OCSLA contains no comparable statutory language. Moreover, prior to 1959, when Congress amended Section 3124(a) to include that specific language, this Court had held that the provision's generally-worded bar on state taxation of federal obligations (contained in Rev. Stat. § 3701 (1873-1874 ed.), 31 U.S.C. (1952 ed.) 742) did not prevent states from imposing franchise, estate and inheritance taxes on corporate shares or business franchises, based on the value of the underlying assets, including United States obligations. See generally *American Bank & Trust Co.* v. *Dallas County*, 463 U.S. 855, 858, 863-864 (1983) (citing cases).

To be sure, as Shell states (Br. 25), it is well settled by decisions of this Court that "states cannot impose a tax on private property or persons within an area of exclusive federal jurisdiction, absent the consent of Congress." But those decisions establish only that the activities of a business occurring within an area of exclusive federal jurisdiction, *like* its activities occurring within another State's borders, cannot be taxed by a State as though the activities were occurring within the taxing State's own jurisdiction.[11] None of those decisions supports Shell's far different assertion that the activities of a company occurring within an area of exclusive federal jurisdiction, *unlike*

[11] The cases cited by Shell concerning areas of exclusive federal jurisdiction all involved challenges to state taxes—a state realty tax (*S.R.A., Inc.* v. *Minnesota,* 327 U.S. 558 (1946)), gross sales tax (*James* v. *Dravo Contracting Co.,* 302 U.S. 134 (1937)), and ad valorum tax on private property (*Humble Pipe Line Co.* v. *Waggonner,* 376 U.S. 369 (1964))—that can be imposed only on activities or property occurring or located exclusively within the State's territorial jurisdiction. See, *e.g., S.R.A., Inc.* v. *Minnesota,* 327 U.S. at 562 ("The right of a State to tax realty directly depends primarily upon its territorial jurisdiction over the area."); *James* v. *Dravo Contracting Co.,* 302 U.S. at 138 (quoting Code of West Virginia 1931, ch. 11, Art. 13, amended effective May 27, 1933, Acts of 1933, ch. 33) (footnote omitted; emphasis added) (" 'Upon every person engaging or continuing *within this state* in the business of contracting, the tax shall be equal to two per cent of the gross income of the business.' "); see also *Tyler Pipe Industries, Inc.* v. *Washington State Dep't of Revenue,* No. 85-1963 (June 23, 1987), slip op. 18. None involved an apportioned state income tax. Similarly unpersuasive is Shell's reliance (Br. 25-26) on this Court's decision in *Ramah Navajo School Bd.* v. *Bureau of Revenue,* 458 U.S. 832 (1982). That case involved a state gross receipts tax, the application of which this Court held preempted because the State's provision of benefits to the taxpayer "for its activities *off the reservation*" can not "justify a tax imposed on the construction of school facilities *on tribal lands* pursuant to a contract between the tribal organization and the non-Indian [taxpayer]" (*id.* at 843-844 (emphasis in original)). Here, no tax is being imposed by Iowa on activities occurring on the OCS.

activities occurring within the borders of another State, cannot be considered in determining the amount of the company's total income that can be fairly attributed to activities occurring *within* the taxing State's jurisdiction. Nor does any of those decisions in any way suggest that the safeguards from extraterritorial taxation provided by the Due Process and Commerce Clauses, which allow states to measure in-state value in that manner for apportionment purposes, do not adequately protect the exclusivity of federal jurisdiction.[12]

Indeed, quite the contrary is suggested by this Court's decision in *Polar Co.* v. *Andrews,* 375 U.S. 361 (1964). In that case, the Court rejected the taxpayer's claim that a state law "which imposes a tax in the amount of 15/100 of 1 cent upon each gallon of milk distributed by a Florida distributor" is "invalid" and "beyond the jurisdiction of the State" "[t]o the extent the computation of the tax includes milk which it sells to * * * federal enclaves over which the United States exercises exclusive jurisdiction" (*id.* at 381). The Court distinguished cases (including a case upon which Shell here relies) in which "the tax was deemed to fall upon

[12] For basically the same reason, Shell errs in arguing (Br. 27-28) that its preemption claim is buttressed by "[t]he failure of the OCSLA to incorporate the Buck Act[ ]," which provides that "[n]o person shall be relieved from liability for any income tax levied by any State, or by any duly constituted taxing authority therein, having jurisdiction to levy such a tax, by reason of his residing within a Federal area or receiving income from transactions occurring or services performed in such area * * * " (4 U.S.C. 106(a)). The validity of Iowa's tax apportionment method, which is aimed at measuring in-state values, does not require application of the Buck Act. Because, moreover, the Buck Act allows a state to tax activities occurring in a federal area located within the State's borders as though they were occurring within the State's political jurisdiction, it is understandable why Congress chose not to apply the Buck Act to the OCS; as described at pages 19-20, 22-28, *infra,* Congress specifically decided not to allow states to tax activities on the OCS on that basis.

the facilities of the United States or upon activities conducted within these facilities, the principle of [those] cases being that there was nothing occurring within the State, beyond the borders of the federal enclave, to which the tax could attach" (*id.* at 382). The Florida tax was not similarly infirm, the Court held, because it "is on the privilege of engaging in the business of distributing milk or acting as distributor * * *. The incidence of the tax appears to be upon the activity of processing or bottling milk, in a plant located within Florida, and not upon work performed on a federal enclave or upon the sale and delivery of milk occurring within the boundaries of federal property" (*ibid.*).[13]

Although this case, unlike *Polar Co.* v. *Andrews, supra,* concerns methods of apportionment to avoid subjecting activities within a federal enclave to extraterritorial state income taxation, the Court's reasoning in *Polar Co.* is nonetheless pertinent. By analogy, *Polar Co.* strongly suggests that Iowa's tax is not preempted by the exclusive nature of federal jurisdiction over the OCS so long as the "incidence" of state tax is on in-state activity and "not upon work performed on a federal enclave." The Court's analysis, moreover, leaves little basis for contending that a state tax does not meet that standard where, as here, it comports with Due Process and Commerce Clause requirements, the very purpose of which is to confine a tax to local activities.

2. Section 1333(a)(2)(A), which provides that "State taxation laws shall not apply to the [OCS]," also fails to support Shell's preemption claim. We agree with Shell (Br. 26) that "[i]t is hard to imagine simpler or more sweeping language to prohibit state taxation of the income attributable to the production of oil and gas on the Shelf." But, as

[13] The Court's extended analysis in *Polar Co.* v. *Andrews, supra,* is perhaps especially significant because, as it remarked at the conclusion of its opinion (see 375 U.S. at 383), the Court could have simply relied on the Buck Act to sustain the challenged Florida tax.

we have explained, that language is not enough to sustain Shell's challenge to Iowa's tax apportionment method—which is designed to tax Shell's income-producing activities in Iowa rather than on the OCS. Nothing in that statutory language expresses a congressional intent to expand upon the established Due Process and Commerce Clause restrictions that assure against extraterritorial taxation.

The statutory context of Section 1333(a)(2)'s prohibitory language, moreover, is both contrary to Shell's broad preemption theory and consistent with our view that Iowa's tax is not preempted. Section 1333 generally declares the "[l]aws and regulations governing [OCS] lands." As we have noted, subsection (a)(1) of that Section provides that "[t]he Constitution and laws and civil and political jurisdiction of the United States are extended to the * * * [OCS] * * * to the same extent as if the [OCS] were an area of exclusive Federal jurisdiction located within a State." Subsection (a)(2)(A) then "borrows the 'applicable and not inconsistent' laws of the adjacent States as surrogate federal law" in order to "fill the substantial 'gaps' in the [statute's] coverage." *Gulf Offshore Co.* v. *Mobil Oil Corp.*, 453 U.S. 473, 480 (1981); *Rodrigue* v. *Aetna Casualty & Surety Co.*, 395 U.S. 352, 357 (1969). Section 1333(a)(2)(A) specifically provides that, "[t]o the extent that they are applicable and not inconsistent with * * * Federal laws * * * the civil and criminal laws of each adjacent State * * * are declared to be the law of the United States for that portion of the * * * [OCS] * * * which would be within the area of the State if its boundaries were extended seaward to the outer margin of the [OCS]." It is in this context that subsection (a)(2)(A) adds the final caveat, upon which Shell so heavily relies, that "State taxation laws shall not apply to the [OCS]."

This statutory context suggests that Congress, in adding that final caveat, was addressing only two questions: (1)

whether "[t]he * * * laws * * * of the United States" that subsection (a)(1) "extended to the * * * [OCS] * * * as if [it] were an area of exclusive Federal jurisdiction located within a State," include the Buck Act, 4 U.S.C. 106, which allows a State to tax activities in an area of exclusive federal jurisdiction located within a State as though they were occurring within the State's own territory (see note 12, *supra*); and (2) whether state taxation laws should be included among those state laws borrowed by the federal government from adjacent States for application to the OCS. In unequivocally answering both these questions in the negative, Congress made clear that state taxation laws were not adopted as applicable federal law, and that a State cannot tax activities on the OCS as if those activities were occurring within the State's own jurisdictional borders.

Section 1333(a)(2)(A) thus precludes a State from imposing a property tax on property (such as a drilling platform) located on the OCS or from imposing an excise tax on an event (such as extraction of oil) occurring on the OCS. See *Commonwealth Edison Co.* v. *Montana,* 453 U.S. 609, 617 (1981). The statute, however, imposes no restriction, expressly or by implication, on the States' ability to tax the activities of a unitary business engaged in interstate commerce, beyond the established limitations on extraterritorial taxation imposed by the Due Process and Commerce Clauses. The statute, after all, says only that "State taxation laws shall not apply to the [OCS]"; it does not purport to direct the method by which a State must determine the amount of a unitary business's income that is fairly attributable to its in-state activities.

3. The third provision upon which Shell relies (Br. 26-27), Section 1333(a)(3), likewise fails to support Shell's preemption claim. By its express terms, the provision is wholly inapposite to the issue presented here. It states that "[t]he provisions of this section for adoption of State law as

the law of the United States shall never be interpreted as a basis for claiming any interest in or jurisdiction on behalf of any State for any purpose over the * * * [OCS]." Hence, the provision does not purport to preempt state laws, but instead simply makes clear that other provisions of the same federal statute "shall never be interpreted" as authorizing otherwise invalid state laws. Like the language in subsection (a)(2)(A), therefore, the language in subsection (a)(3) merely guards against a misreading of other provisions of OCSLA, and has no independent preemptive force.[14]

4. The foregoing analysis of the statutory language on which Shell relies also serves to refute Shell's claim (Br. 43) that our reading of Section 1333(a) deprives its provisions of any meaning. Whether a statutory provision has "meaning" does not depend solely on whether it has independent preemptive force.[15] Indeed, Shell itself admits that there was a more limited purpose of both subsections (a)(2)(A) and (3). Shell acknowledges (Br. 26) that Congress added

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[14] Another provision of OCSLA also comports with our position here. "In order to prevent the lessees from receiving a windfall in being relieved from paying a tax they contemplated paying when they bid in their leases with the States," 43 U.S.C. 1335(a)(9) provides that lessees must "pay[ ] to the Secretary [of the Interior] as an additional royalty on the production from the lease * * * a sum of money equal to the amount of the severance, gross production, or occupation taxes which would have been payable on such production to the State issuing the lease under its laws as they existed on August 7, 1953." S. Rep. 411, 83d Cong., 1st Sess. 3 (1953); see 99 Cong. Rec. 6966 (1953) (remarks of Sen. Cordon). Significantly, Congress did not correspondingly increase royalty payments by an amount intended to approximate apportioned state income taxes that had previously been imposed on activities of lessees occurring within the taxing States' borders.

[15] As this Court has recognized, other provisions for tax immunity in federal statutes are "principally a restatement of the constitutional rule." See *First Nat'l Bank* v. *Bartow County Bd. of Tax Assessors,* 470 U.S. 583, 593 (1985).

the explicit prohibitions on state taxation "because 43 U.S.C. § 1333(a)(2)(A) incorporates certain state laws as surrogate federal law applicable to the OCS" and, hence, "Congress could not rest with the general preemptive implications of exclusive federal jurisdiction."

Ultimately, therefore, Shell's "plain language" argument collapses into a single contention: that the test for determining whether an apportioned state income tax violates limitations on extraterritorial taxation is different where, as in this case, a unitary business is conducting some of its activities in an area that Congress described as an area of exclusive federal jurisdiction. For the reasons we have already given, we disagree and believe that the same Due Process and Commerce Clause limitations on extraterritorial taxation apply as where a unitary business is conducting some of its activities in another State—or, for that matter, in the District of Columbia (which, under Article I of the Constitution, is subject to plenary legislative power of Congress). Because Shell concedes that Iowa's tax does not offend those constitutional limitations, its preemption claim should be rejected.

C. OCSLA's Legislative History Does Not Support Shell's Claim That Congress Intended To Require Iowa To Exclude From Shell's Preapportioned Income Base The Wellhead Value Of OCS Oil And Gas

The legislative history of OCSLA also supports our reading of the statutory language. "Congress enacted OCSLA in the wake of decisions by this Court that the Federal Government enjoyed sovereignty and ownership of the * * * [OCS] to the exclusion of adjacent States" (*Gulf Offshore Co.* v. *Mobil Oil Corp.*, 453 U.S. at 479 n.7). See *United States* v. *Texas*, 339 U.S. 707 (1950); *United States* v. *Louisiana*, 339 U.S. 699 (1950); *United States* v. *California*, 332 U.S. 19 (1947). Whether the laws of the adjacent

States, including their power of taxation, should extend to the OCS as they had purported to do prior to those decisions, was a central focus of congressional concern and debate. Congress nowhere evinced any intent to reduce exposure of private lessees (such as Shell) to state income tax based, as required by the Due Process and Commerce Clauses, on income attributable to their in-state business activities.

1. Early bills, none of which was enacted, typically provided for extension of the laws of the adjacent States, including their power of taxation, to the OCS. See, *e.g.*, H.R. 4484, 82d Cong., 1st Sess. § 8(a) (1951); 97 Cong. Rec. 9206 (1951); H.R. Rep. 695, 82d Cong., 1st Sess. 7, 13 (1951); Christopher, *The Outer Continental Shelf Lands Act: Key to a New Frontier*, 6 Stan. L. Rev. 23, 29 & nn.28, 29 (1953). In the 83d Congress, a bill was introduced that would have permitted a more limited scope for state taxation, allowing the imposition of only severance or production taxes. See H.R. 4198, 83d Cong., 1st Sess. § 8(a) (1953); H.R. Rep. 215, 83d Cong., 1st Sess. 8 (1953). On the House floor, however, that provision was deleted and was replaced by the prohibition on state taxation that Shell relies upon in this case. See 99 Cong. Rec. 2511-2512, 2571, 2575 (1953).

The amended bill passed the House on two occasions. The House first passed the prohibition as part of H.R. 4198 (see 99 Cong. Rec. 2638 (1953)), which concerned both submerged lands (offshore lands within the three-mile limit) and the OCS (offshore lands outside the three-mile limit). After the Senate decided it preferred to address the OCS in a separate bill,[16] the House passed a new bill, H.R. 5134, which was concerned exclusively with the OCS and which

[16] Congress enacted the submerged lands legislation prior to its enactment of OCSLA. See Submerged Lands Act, 43 U.S.C. 1301 *et seq.*

was identical in all relevant respects to the prior bill (H.R. 4198). See H.R. 5134, 83d Cong., 1st Sess. § 9(a) (1953); 99 Cong. Rec. 495 (1953); H.R. Rep. 413, 83d Cong., 1st Sess. 1-2, 4 (1953).

The bill that eventually passed the Senate was S. 1901, and, as with H.R. 4198, the process of its drafting reflects Congress's exclusive concern regarding taxation with the authority of adjacent States to treat, for tax purposes, the OCS as property within their borders. When first introduced, S. 1901 did not envision the application of any state laws to the OCS, providing instead that the OCS should be governed by general principles of federal maritime law. See S. 1901, 83d Cong., 1st Sess. § 4(a) (1953). The bill was then amended in Committee to adopt a new approach, which was the approach ultimately adopted by the Senate as a whole. See 99 Cong. Rec. 7265 (1953). First, the reported bill provided that federal law should extend to the OCS "to the same extent as if [it] were an area of exclusive Federal jurisdiction located within a State." S. Rep. 411, 83d Cong., 1st Sess. 15 (1953) (emphasis omitted)). Second, the reported bill adopted all "applicable and not inconsistent" laws of the adjacent States as the governing federal law "for that portion of the * * * [OCS] which would be within the area of the State if its boundaries were extended seaward" (*ibid.* (emphasis omitted)). Hence, unlike earlier legislative proposals, S. 1901 as reported adopted adjacent state law as federal law, rather than directly extending adjacent state jurisdiction to the OCS. See *Gulf Offshore Co.* v. *Mobil Oil Corp.*, 453 U.S. at 480; *Rodrigue* v. *Aetna Casualty & Surety Co.*, 395 U.S. at 355-357; Christopher, *supra,* 6 Stan. L. Rev. at 39-43.

The Senate Committee also added a third provision to S. 1901, which was intended to ensure that the provisions just described would not be read as conferring any jurisdiction on adjacent States to extend their power of taxation to the

OCS. Section 4(a)(3) of the reported bill provided in "precise unequivocal language" that "[t]he provisions of this section for adoption of State law as the law of the United States shall never be interpreted as a basis for claiming any interest in or jurisdiction on behalf of any State for any purpose over * * * the [OCS], or the property and natural resources thereof or the revenues therefrom" (S. Rep. 411, *supra,* at 11, 16 (emphasis omitted)). The accompanying Senate Report explained that "under the terms of S. 1901, as reported, State taxation laws necessarily are excluded from applicability in this area of exclusive Federal jurisdiction not inside the boundaries of any State (*id.* at 3; see also 99 Cong. Rec. 6963-6964 (1953) (remarks of Sen. Cordon)).

The final version, drafted by the Conference Committee, simply added the House bill's express prohibition on state taxation to the federal-law scheme crafted by the Senate. See H.R. Conf. Rep. 1031, 83d Cong., 1st Sess. (1953); 99 Cong. Rec. 10419 (1953). During Senate discussion of the conference substitute, the Senate sponsor of the legislation noted that the House language had been "requested in a super-abundance of caution" and expressed the view that the addition of the House language was "unnecessary" and that "[i]t add[ed] nothing to and took nothing from the bill as it passed the Senate." 99 Cong. Rec. 10471-10472 (1953) (remarks of Sen. Cordon). The legislative history therefore shows that Congress's addition of the House language effected no change in the congressional design, which was confined to eliminating the authority of the adjacent States to treat, for the purpose of asserting their power of taxation, the OCS as property within their borders.

2. The legislative debates further confirm the limited purpose of the statutory language upon which Shell relies. Proponents of state taxation argued that Congress should confer on the adjacent States taxation authority equivalent

to that provided in the Mineral Lands Leasing Act of 1920, § 32, 30 U.S.C. 189, with respect to public lands within a state's borders. See, *e.g.*, 99 Cong. Rec. 2509-2510, 2535 (1953) (remarks of Rep. Wilson); *id.* at 7228 (remarks of Sen. Ellender). They argued that the burdens imposed on adjacent States by OCS activities—particularly the use of public facilities by employees—justified state taxing authority. They accordingly supported amendments that would, in effect, "give coastal States the right to extend their jurisdiction to these [OCS] lands" (*id.* at 7230 (remarks of Sen. Ellender)). See *id.* at 2505 (remarks of Rep. Willis); *id.* at 7228 (remarks of Sen. Ellender); *Outer Continental Shelf: Hearings on S. 1901 Before the Senate Comm. on Interior and Insular Affairs,* 83d Cong., 1st Sess. 277-278 (1953) [hereinafter *Senate Hearings*] (remarks of Sen. Long); *id.* at 185 (testimony of School Lands Board of Texas); *id.* at 189-191 (testimony of John Shepperd, Attorney General of Texas); see also *id.* at 193 (remarks of Sen. Daniel); *id.* at 265-267 (testimony of Fred S. LeBlanc, Attorney General of Louisiana); *Maryland* v. *Louisiana,* 451 U.S. 725, 730 n.5 (1981).

Opponents of state taxation responded that the OCS, being outside the three-mile limit, was not at all analogous to public land within a State's borders. They urged that extension of the power of taxation beyond a State's borders would be "unconstitutional" and constitute "larceny" (see 99 Cong. Rec. 2506 (1953) (remarks of Rep. Celler); *id.* at 2524 (remarks of Rep. Machrowicz); *id.* at 2571-2572 (remarks of Rep. Keating); see also *Senate Hearings* 280 (remarks of Sen. Anderson)), and that it would confer a windfall upon the few adjacent States at the expense of the non-adjacent States. See 99 Cong. Rec. 2523 (1953) (remarks of Rep. Rodino); *id.* at 2524 (remarks of Rep. Machrowicz).

Significantly, no opponent of taxation by the adjacent States ever suggested that a State's use of an apportionment

formula to calculate the portion of a unitary business's income attributable to in-state activities would similarly be "unconstitutional" or "larceny" because a portion of the business's activities took place on the OCS. The opponents instead answered the suggestion of others that the States would be powerless to raise revenues to offset the burdens caused by OCS development by indicating that state authority to tax related activities occurring within the adjacent State's jurisdiction would not be diminished. The sponsor of the legislation in the Senate noted that "[t]he companies holding the leases will have to build and maintain very substantial shore installations within the abutting States, and such shore installations will be subject to local taxes." 99 Cong. Rec. 7254 (1953) (remarks of Sen. Cordon)). During Senate Hearings, Assistant Attorney General Rankin similarly explained that an adjacent State would be able "to tax the shore bases" and that, although the State "would not be collecting [a severance tax], * * * it certainly is getting lots of others" (*Senate Hearings* 661-662).

3. Shell's contrary reading of the legislative history relies (Br. 31-36) principally on an isolated statement by Senator Long expressing his personal belief that, absent amendment of the Senate bill (S. 1901), "employers of these workers are subject neither to the State's severance tax, property tax, nor the tax on corporate profits" (see 99 Cong. Rec. 7261 (1953) (remarks of Sen. Long); S. Rep. 411, *supra,* at 67 (minority report of Sen. Long)).[17] Shell's

[17] The other statements from the legislative history cited by Shell (Br. 28-30) generally condemn the power of state taxation of the OCS, but they do not even arguably touch on the apportionment question presented by this case. Presumably for this reason, Shell is forced to rest its argument ultimately on the odd assertion that "Congress's silence * * * speaks volumes" (*id.* at 33) and on a lengthy discussion of the 1978 amendments to OCSLA (*id.* at 37-41), which neither amended any of the pertinent language of OCSLA nor spoke in any manner to the state taxation issue presented here.

reliance on Senator Long's statement, particularly his reference to a "tax on corporate profits," is unpersuasive for two reasons.

First, the statement does not speak to the apportionment issue presented in this case. Senator Long's remark was expressly premised on the assumption that a private lessee such as Shell would not be engaging in activities within the taxing State's borders. See 99 Cong. Rec. 7261 (1953); S. Rep. 411, *supra,* at 67. Indeed, contrary to Shell's claim (Br. 32), it cannot fairly be assumed that Senator Long's reference to a "tax on corporate profits" referred to an apportioned state income tax. Although, as Shell points out (*id.* at 32 & n.33), the State of Louisiana was then generally utilizing an apportionment formula to calculate the portion of a unitary business's income attributable to in-state activities, Louisiana apparently did not then consider the production of crude oil in Louisiana to be part of a unitary business and, accordingly, assessed an income tax on oil production based on separate accounting (at least where the taxpayer did not also operate an in-state refinery or factory). See *Texas Co.* v. *Cooper,* 236 La. 380, 107 So.2d 676 (1958); see generally J. Hellerstein, *State Taxation: I Corporate Income and Franchise Taxes* ¶ 8.11[2] (1983). Senator Long's reference to the state's corporate profits tax therefore most likely referred to an *un*apportioned income tax measured by separate accounting and, hence, his conclusion that the tax would be barred by OCSLA was based on the fact that the authority of a State to levy such an unapportioned tax depends on the taxable event's occurrence within the State's jurisdiction.[18]

[18] Equally unavailing is Shell's reliance (Br. 35-36) on a remark by Representative Keating in which he expresses the concern "that state taxes on OCS oil and gas would decrease the net value of the leases and thus reduce the amounts lessees would be willing to pay to the government" (*id.* at 35, citing 99 Cong. Rec. 2571 (1953)). That remark, which Representative Keating expressly directed to " '[t]he tax imposed by the adjacent States' " (99 Cong. Rec. 2571 (1953)), merely explains why Congress chose not to allow the adjacent States to extend their territorial jurisdiction to tax to the OCS (*i.e.*, to tax the OCS as if it were within their borders). The remark does not suggest that Congress intended to preempt all state taxes (or other state laws) that might incidentally affect federal revenues. Cf. *Commonwealth Edison Co.* v. *Montana,* 453 U.S. 609, 630-632 (1981).

In any event, any reliance on the "criticisms by * * * Senator[ ] * * * Long" is misplaced because he "opposed the bill that eventually became OCSLA" (*Gulf Offshore Co.* v. *Mobil Oil Corp.*, 453 U.S. at 483 (footnote omitted)). It is well settled that " '[t]he fears and doubts of the opposition are no authoritative guide to the construction of legislation' " (*ibid.*, quoting *Schwegmann Bros.* v. *Calvert Distillers Corp.*, 341 U.S. 384, 394 (1951)).

In sum, the legislative history of OCSLA provides no support for, and indeed tends to contradict, Shell's preemption claim. It confirms what the statutory language itself indicates—that Congress simply was not addressing the question of apportionment methods in state taxation of in-state income of a unitary business. There is, accordingly, no basis for Shell's statutory claim.

CONCLUSION

The judgment of the Iowa Supreme Court should be affirmed.

Respectfully submitted.

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In The

Supreme Court of the United States

October Term, 1987

SHELL OIL COMPANY,
Appellant,

v.

IOWA DEPARTMENT OF REVENUE,
Appellee.

ON APPEAL FROM THE SUPREME COURT OF IOWA

AMICUS CURIAE BRIEF OF THE STATE OF CALIFORNIA IN SUPPORT OF APPELLEE

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STATEMENT OF INTEREST OF CALIFORNIA AS AMICUS CURIAE

The State of California is among the 46 states which impose a tax on or measured by income attributable to sources within their respective borders. California Revenue and Taxation Code § 25101. All of the states imposing this kind of tax use some form of formula apportionment to determine the amount of income attributable to sources within and without the state. California and most other states have adopted the Uniform Division of Income for Tax Purposes Act. These states use a three-factor formula. Iowa uses a one-factor formula. All states apply their

respective formulas to the total amount of unitary business income, as defined by the state. The amounts of income and the factors included in this calculation may vary from state to state, depending on how the state defines the geographic area which comprises the unitary tax base. These variations, however, have no relevance to the issues of this case.

Appellant challenges Iowa's ability to include the income which appellant attributes to the Outer Continental Shelf in the amount of unitary business income which is apportioned by formula, on the basis that Iowa is prohibited from doing so by the Outer Continental Shelf Lands Act. Appellant's challenge goes to the very heart of the entire unitary method of formula apportionment of income, which is used by California, Iowa and 44 other states. If the states were denied the use of this method, they would be unable to fairly and efficiently administer the taxation of multistate businesses. California thus has a vital interest in preserving from this challenge the system of formula apportionment of income on which it relies to produce a substantial portion of its revenues.

———o———

ARGUMENT

I. STATES PROPERLY APPLY A FORMULA TO A TAXPAYER'S TOTAL BUSINESS INCOME TO DETERMINE WHAT PORTIONS OF THAT INCOME ARE DERIVED FROM WITHIN AND WITHOUT THE STATE.

California has been administering a system of formula apportionment for over fifty years, and its system has

been fully tested in the state and federal courts. California's system is illustrative of, and comparable to, the systems employed by Iowa and most other states, in that respective tax bases generally include income and factors from activities on the Outer Continental Shelf. For the purpose of illustration, this discussion is confined to California law, insofar as it describes a particular state system of apportionment.

The unitary business/formula apportionment method of accounting is now codified in the Uniform Division of Income for Tax Purposes Act, which California adopted in 1966. California Revenue and Taxation Code Section 25120, et seq. California law requires that the California income of a unitary business which operates both inside and outside California be determined through formula apportionment. *Superior Oil Company v. Franchise Tax Board* 60 Cal.2d 406, 411 (1963); *Honolulu Oil Corporation v. Franchise Tax Board* 60 Cal.2d 417, 425 (1983).

The unitary business principle has been described as follows:

> Where the properties and activities [of a corporation] within and without the jurisdiction are an inseparable portion of a business carried on both within and without the jurisdiction, the computation of the income attributable thereto requires a computation of the income of the business as a whole or as a unit and an apportionment or allocation of the total to the various parts. This necessity of dealing with the business as a *unit*, taking into account income from property and activities without the jurisdiction as well as within, gives rise to the classification of the business as a

> unitary business. Thus a unitary business may be defined simply as any business which is carried on partly within and partly without the taxing jurisdiction.

Keesling and Warren, *The Unitary Concept in the Allocation of Income* 12 Hast. L. Rev. 42, 46 (1960); emphasis in original.

Where a unitary business exists, a state is " 'faced with the impossibility of allocating specifically the profits earned by the processes within its borders.' " *Butler Bros. v. McColgan* 315 U.S. 501, 507 (1942) (quoting *Underwood Typewriter Co. v. Chamberlain* 254 U.S. 113, 121 (1920)). It is the impossibility of determining the actual source of profits and losses of a unitary business which provides the rationale for apportioning the income of such a business by means of a formula which reflects the relative extent of its business activity in each of the taxing jurisdictions involved.

The purpose of this method of apportionment is to reflect contributions of the various elements of a unitary business to the profitablity of the business as an economic whole. In most states, including California, a three-factor formula, based on property, payroll, and sales, is used. Each factor is a fraction, the numerator of which is the dollar value of the particular category attributable to the taxing jurisdiction, and the denominator of which is the dollar value of that particular category for the unitary business everywhere. The three fractions are added together and the sum is divided by three. Net income subject to apportionment is then multiplied by the resulting fraction (usually expressed as a percentage) in order to determine that portion of the total business net income which is attributable to activity within the taxing jurisdiction.

In *Underwood Typewriter Co. v. Chamberlain* 254 U.S. 113 (1920), the United States Supreme Court considered the constitutionality of the application of the unitary method to a domestic corporation which conducted business activities in several states. The court stated:

> The profits of the corporation were largely earned by a series of transactions beginning with manufacture in Connecticut and ending with sale in other States. In this it was typical of a large part of the manufacturing business conducted in the State. The legislature in attempting to put upon this business its fair share of the burden of taxation was faced with the impossibility of allocating specifically the profits earned by the processes conducted within its borders. It, therefore, adopted a method of apportionment which, for all that appears in the record, reached, and was meant to reach, only the profits earned within the State.

Underwood Typewriter Co. v. Chamberlain 254 U.S. at 120-121

Four years later, the United States Supreme Court coined the term "unitary business" in *Bass, Etc., Ltd. v. Tax Comm.*, 266 U.S. 271, 282 (1924). In *Bass*, the court held that a formula could be applied to apportion the profits of an English company which sold its ale in New York. The court stated:

> So in the present case we are of the opinion that, as the Company carried on the *unitary business* of manufacturing and selling ale, in which its profits were earned by a series of transactions beginning with the manufacture in England and ending in sales in New York and other places—the process of manufacturing resulting in no profits until it ends in sales—the State was justified in attributing a just proportion of the profits earned by the company from such *unitary business.*

Bass, Etc., Ltd. v. Tax Comm., 266 U.S. at 282; emphasis added.

The court again recognized the necessity for formula apportionment in *N & W Ry. Co. v. No. Carolina* 297 U.S. 682 (1935) and stated the following with respect to a statutory formula then under attack:

> Taxpayer and state would be swamped with administrative difficulties if left to struggle through every case without the aid of a formula of ready application. In the perplexities besetting the process of assessment the statute is the outcome of a reasonable endeavor to arrive at a proportion of general validity.

N & W Ry. Co. v. No. Carolina 297 U.S. at 685

This court has rendered a long line of decisions which recognize that formula apportionment is a valid means of determining the amount of income of a unitary business fairly attributable to sources within a particular taxing jurisdiction—that is, formula apportionment of all business income, regardless of where it would be allocated by separate accounting. See, e.g., *Container Corp. v. Franchise Tax Bd.*, 463 U.S. 159; *Exxon Corporation v. Wisconsin Department of Revenue* 447 U.S. 207 (1960); *Mobil Oil Corporation v. Commissioner of Taxes,* 445 U.S. 425; *Moorman Mfg. Co. v. Blair* 437 U.S. 267 (1978); *Butler Bros. v. McColgan,* 315 U.S. 501 (1942); *Bass, Etc. Ltd. v. Tax Commissioner,* 266 U.S. 271 (1924).

Recently, in *Container Corp. v. Franchise Tax Bd.*, 463 U.S. 159, this court upheld California's application of the unitary method to an organization composed of a domestic parent and several subsidiary corporations, incorporated both within the United States and various foreign countries.

II. THE INCLUSION BY A STATE IN ITS APPORTIONABLE INCOME BASE OF INCOME WHICH APPELLANT ATTRIBUTES BY THE USE OF SEPARATE ACCOUNTING TO THE OUTER CONTINENTAL SHELF DOES NOT RESULT IN THE TAXING OF INCOME DERIVED FROM THE OUTER CONTINENTAL SHELF.

There are basically two accounting methods which are employed to determine where income is earned—unitary business/formula apportionment and separate accounting. Formula apportionment views a business as a unit stretching across jurisdictional borders and attempts to allocate net income to each locality in which a business operates, in the proportion that the business activities conducted by the corporation in a particular locality bears to the business activities conducted by the corporation in all localities. Separate accounting views the various localities of a multistate or multinational enterprise as functionally separate from one another and determines the income attributable to any particular jurisdiction on the basis of geographical and transactional accounting records maintained for the activity of the unit located within that jurisdiction.

California, Iowa, and other states use formula apportionment to attribute income to sources within and without their respective jurisdictions. In all these states, the denominator of the formula used includes the factor(s) attributable to the Outer Continental Shelf, and the numerator does not. For this reason, the income which the states apportion *outside* of their respective jurisdictions includes the income which has its source in the Outer Continental Shelf. Thus, *the very operation of the formula itself* excludes income attributable to the Outer Continen-

tal Shelf from that income attributable to, and subjected to tax by, the respective states.

Appellant, on the other hand, is using the separate accounting method to attribute income to the Outer Continental Shelf. Appellant is then asserting that because this income, which it has attributed by separate accounting to the Outer Continental Shelf, is included by Iowa in the apportionable income base, Iowa must be taxing Outer Continental Shelf income and thus asserting jurisdiction over the Outer Continental Shelf in violation of federal law.

The flaw in Shell's line of reasoning is that it is using separate accounting to show that Outer Continental Shelf income is being taxed. This it is not permitted to do.

In *Mobil Oil Corp. v. Commissioner of Taxes,* 445 U.S. 425 (1980), this court rejected the taxpayer's contention that the source of income earned by a unitary business must be ascertained by separate geographic accounting.

> [S]eparate accounting, while it purports to isolate portions of income received in various States, may fail to account for contributions to income resulting from functional integration, centralization of management, and economies of scale. *Butler Bros. v. McColgan,* 315 U.S., at 508-509. Because these factors of profitability arise from the operation of the business as a whole, it becomes misleading to characterize the income of the business as having a single identifiable "source." Although separate geographical accounting may be useful for internal auditing, for purposes of state taxation it is not constitutionally required.

Mobil Oil Corp. v. Commissioner of Taxes, 445 U.S. at 438. Thus, in *Butler Bros.* and *Mobil, supra,* among other cases, this court has specifically disapproved of the use of

separate accounting to impeach the results of formula apportionment.

In *Container Corp. v. Franchise Tax Bd.* 463 U.S. 159, the taxpayer used the same line of reasoning now used by Shell in an effort to show that formula apportionment of total worldwide income resulted in the taxation of foreign income. In that case, the court noted that a state is not constitutionally permitted to "tax value earned outside its borders," citing *ASARCO, Inc. v. Idaho State Tax Commissioner,* 458 U.S. 307 (1982). The court evaluated California's system of formula apportionment of total worldwide income in light of this prohibition and held specifically that California's system does *not* result in taxation of extraterritorial values.

The principle is stated in Rudolph, *State Taxation of Interstate Business: The Unitary Business Concept and Affiliated Corporate Groups,* 25 Tax L. Rev. 171, 205 (1970), as follows:

> [F]oreign source income is no different from any other income when it comes to determining, by formulary apportionment, the appropriate share of the income of a unitary business taxable by a particular state. This does not involve state taxation of foreign source income any more than does apportionment—in the case of a multistate business—involve the taxation of income arising in other states. In both situations the total income of the unitary business simply provides the starting point for computing the in-state income taxable by the particular state.

Since the inclusion of "foreign" income in the apportionable income base has been held not to constitute taxation of extraterritorial values, it follows that inclusion of Outer Continental Shelf income in the base likewise cannot constitute taxation of Outer Continental Shelf values.

CONCLUSION

The system of formula apportionment of a unitary income base does not result in a state's taxing extraterritorial values. It reaches only income that fairly represents the extent of business activity *within* the state. By its very operation, the formula excludes from the measure of tax that portion of the total income which fairly represents all business activities which take place *without* the state, including the business activity which takes place on the Outer Continental Shelf.

Appellant seeks to use separate accounting to carve out a portion of the unitary income subject to apportionment. If appellant can use separate accounting to carve out this particular portion, what is to prevent others from using separate accounting to carve out other portions attributable to foreign countries, federal enclaves, Indian lands, and other states, until the entire unitary method is in tatters? To sustain appellant's position would be to completely undermine the theoretical and constitutional basis for the unitary method of taxation, used by California, Iowa and all other states imposing a tax on or measured by income.

This court should sustain the unitary method once again, as it has repeatedly done in the past, and reject Appellant's spurious position.

Respectfully submitted,

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In The

Supreme Court of the United States

October Term, 1987

SHELL OIL COMPANY,

Appellant,

v.

THE IOWA DEPARTMENT OF REVENUE,

Appellee.

On Appeal from the Supreme Court of Iowa

BRIEF OF MULTISTATE TAX COMMISSION AS AMICUS CURIAE IN SUPPORT OF APPELLEE

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June 3, 1988

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QUESTION PRESENTED

Whether the Outer Continental Shelf Lands Act precludes the State of Iowa from imposing a tax upon that portion of a unitary net income base which is reasonably attributable to the taxpayer's income producing activities in Iowa.

PARTIES TO THE PROCEEDING

The parties to the proceeding are Shell Oil Company and the Iowa Department of Revenue.

CONSENT

The parties have given their consent pursuant to Rule 36.2 of the Supreme Court Rules to the filing of this Amicus Curiae brief. Copies of the letters of consent are on file with the Clerk of the Court.

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On Appeal from the Supreme Court of Iowa

—o—

BRIEF OF MULTISTATE TAX COMMISSION AS AMICUS CURIAE IN SUPPORT OF APPELLEE

—o—

STATEMENT OF INTEREST OF AMICUS CURIAE MULTISTATE TAX COMMISSION

The Multistate Tax Commission (MTC) is the official administrative agency of the Multistate Tax Compact (Compact) entered into by 18 states[1] and the District of

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1 Alaska, Arkansas, California, Colorado, Hawaii, Idaho, Kansas, Minnesota, Missouri, Michigan, Montana, New Mexico, North Dakota, Oregon, South Dakota, Texas, Utah and Washington.

Columbia as full members and by 10 states[2] as associate members.

The Commission and its member states are concerned with the contention of the Appellant, a corporation which conducts business in many states, that the Court should allow Appellant to carve out of its apportionable business income base that income which Appellant claims is attributable to a specific geographical location.

The stated purposes of the Compact are to:

1. Facilitate proper determination of State and local tax liability of multistate taxpayers, including the equitable apportionment of tax bases and settlement of apportionment disputes.

2. Promote uniformity or compatibility in significant components of tax systems.

3. Facilitate taxpayer convenience and compliance in the filing of tax returns and in other phases of tax administration.

4. Avoid duplicative taxation.

The Commission is vitally interested in assisting the states in preserving their rights to protect their tax bases and to apply their taxes fairly to that portion of every corporate taxpayer's income which is reasonably attributable to the taxpayer's activities within the state.

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2 Alabama, Arizona, Georgia, Louisiana, Maryland, Massachusetts, New Jersey, Ohio, Pennsylvania and Tennessee.

STATEMENT OF THE CASE

The Multistate Tax Commission accepts the Statement of the Case as set forth in the Brief for the Appellee, the Iowa Department of Revenue.

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SUMMARY OF ARGUMENT

I. SHELL, WHILE PURPORTING TO BASE ITS CLAIM ON A FEDERAL STATUTE, IS REALLY ATTACKING FORMULARY APPORTIONMENT; IT SHOULD NOT BE ALLOWED TO SUCCEED IN THAT EFFORT.

Shell purports to accept the validity of the apportionment formula which Iowa uses to determine what amount of Shell's total income is attributable to Iowa for income tax purposes. Yet it attacks the results of that formulary approach on the basis of a claim that it violates a federal statute. Nor does Shell attack the reasonableness of the formulary apportionment results. In thereby conceding that no Due Process or Interstate Commerce Issue lies in the case, Shell really concedes the invalidity of its so-called statutory claim.

II. THE COURT SHOULD REJECT SHELL'S ATTEMPT TO INSULATE IOWA INCOME FROM FAIR TAXATION.

Shell seeks to overthrow the results of formulary apportionment on the basis of its own self-serving application of a method to which it refers as "separate accounting" but which really is nothing more than an income ap-

portionment method that has been tailored to serve Shell's purposes. It should be rejected.

III. THE OUTER CONTINENTAL SHELF LANDS ACT (OCSLA) IS IRRELEVANT TO THE DETERMINATION OF THE AMOUNT OF SHELL'S NET INCOME THAT IS REASONABLY ATTRIBUTABLE TO IOWA.

Iowa's formula seeks to arrive at a portion of Shell's total income that is reasonably attributable to Iowa. It is not, and need not be, concerned with the specific location of any portions of non-Iowa income.

IV. THE COURT SHOULD END THE PRACTICE OF ACCORDING "SEPARATE ACCOUNTING" THE DIGNITY OF AN ACCOUNTING TERM.

The term "separate accounting" is not an accounting term. It is an income attribution term which had arisen in the field of state taxation. But its widespread use in the income attribution context has often caused it to be treated as if it were an accounting term. The entire field of income attribution would be well-served if the Court would take the opportunity in this case to eliminate "accounting" from the income attribution vocabulary. That would help to eliminate much litigation which otherwise can be expected to arise out of false respect for a non-accounting term masking as an accounting term.

V. THE POSITIONS OF IOWA AND FLORIDA ARE COMPATIBLE; NEITHER SEEKS TO TAX ANY PORTIONS OF SHELL'S INCOME THAT IS NOT REASONABLY ATTRIBUTABLE TO ACTIVITIES CARRIED ON WITHIN ITS BORDERS.

Both Iowa and Florida apply a formula to determine the amount of income that is reasonably attributable to activities carried on within their borders. Florida accomplishes the purpose in a two-step procedure. It actually uses the Iowa formula in the first step. If it also applied the Iowa formula in the second step, the result would be the same as if it had applied Iowa's single-stop approach. In applying its own formula in the second step, Florida simply exercises its constitutional prerogative to use a formula of its own choosing.

VI. THE COURT SHOULD REJECT THE INTENDED EFFECTS OF SHELL'S OUT-OF-CONTEXT QUOTATIONS AND MISLEADING IMPLICATIONS.

Shell's incomplete quotes produce misleading impressions. They lack merit and confuse facts; and they imply that this Court and congressional leaders have taken positions which they have not taken.

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ARGUMENT

I. SHELL, WHILE PURPORTING TO BASE ITS CLAIM ON A FEDERAL STATUTE, IS REALLY ATTACKING FORMULARY APPORTIONMENT; IT SHOULD NOT BE ALLOWED TO SUCCEED IN THAT EFFORT.

Shell bases its claim herein on the allegations: 1) that Iowa's apportionment formula attributes to Iowa income that Shell maintains was earned on the Outer Continental

Shelf (OCS); and 2) that that constitutes a violation of the Outer Continental Shelf Lands Act (OCSLA), 43 U.S.C. Sec. 1331 et seq.

Yet, it does not challenge the validity of Iowa's apportionment formula.[3] The philosophical underpinning of formulary apportionment is that it determines the amount of a taxpayer's income that is attributable to the state applying the formula. Therefore, in attacking the results of the formula, Shell is attacking the validity of the formula in the case at hand. It would not be improper to attack the results of the formula by seeking to demonstrate that they are unreasonable[4] or grossly distorted in effect[5], thereby seeking the protection of the Due Process and Interstate Commerce clauses. Shell has chosen not to do that. Rather, it attacks the formula indirectly by reference to the federal statute. In doing so, it generally attacks formulary apportionment, a concept which has always had the blessing of the Court. Shell should not be allowed to succeed in this attempt.

In failing to challenge the validity of the formula and the reasonableness of the result, Shell really concedes that Iowa is taxing only income that is properly attributable to Iowa and that is, by definition, not income earned elsewhere. Therefore, the claimed statutory basis for its complaint is facially defective and should be rejected.

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3 It could hardly do so in view of the fact that the Court upheld the validity of that formula in *Moorman Manufacturing Co. v. Bair*, 437 U.S. 267 (1978).

4 *Base, Ratcliff, & Gretton, Ltd. v. State Tax Commission*, 226 U.S. 271, 283.

5 *Norfolk & Western Railway Co. v. Missouri State Tax Commission*, 390 U.S. 317, 326 (1968).

Even as to the import of the statute, Shell asks the Court to accept a ridiculous conclusion. It would have the Court think, from the legislative history of OCSLA that the non-coastal states, in supporting congressional efforts to eliminate the jurisdiction and power of the coastal states over the OCS, sought to deprive themselves of the right to tax income which is attributable to activities within their borders. Such a contention is laughable. The representatives of the non-coastal states were simply protecting the rights of their own states to share, through the Federal Government, in the riches of the OCS. They were doing so by depriving the coastal states of jurisdiction and control over the OCS. Certainly, the last thing in their minds was that they should or would thereby restrict the authority of their own states to tax income attributable to activities within their own borders.

II. THE COURT SHOULD REJECT SHELL'S ATTEMPT TO INSULATE IOWA INCOME FROM FAIR TAXATION.

Shell claims to be able, by the use of its special attribution method, which it calls "separate accounting", to determine specific income that it claims to have been earned solely on the OCS. Its position flies in the face of the position which the Court has taken for the past sixty-eight years, starting with *Underwood*[6] and continu-

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6 *Underwood Typewriter Co. v. Chamberlain*, 254 U.S. 113 (1920).

ing on through the most recent case on the subject, *Container*[7], that it is impossible to source income to specific geographical locations; and that the results of the application by a state of formulary apportionment, of which the unitary business principle is the linchpin[8], must prevail unless the taxpayer can prove by clear and cogent evidence that extraterritorial values are being taxed[9], that there is no "rational relationship between the income attributed to the state and the intrastate values of the enterprise,"[10] or that the results are unfair[11], or unreasonable[12], or "out of all appropriate proportions to the business transacted . . . in that state."[13] Shell has not even sought to shoulder that burden of proof in this case, but simply relies on a so-called "separate accounting" method to attack the fundamental underpinnings of the unitary business principle.

But Shell does not really seek to apply even "separate accounting as that term has come to be used

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7 *Container Corp. of America v. Franchise Tax Board*, 463 U.S. 159 (1983).

8 *Mobil Oil Corp. v. Commissioner of Taxes of Vermont*, 445 U.S. 425, 439 (1980).

9 *Container, supra* at 164.

10 *Exxon Corp. v. Dept. of Revenue of Wisconsin*, 447 U.S. 207, 219-220 (1980).

11 *Container, supra* at 169.

12 *Bass, Ratcliff, supra* at 283 (1924).

13 *Container, supra* at 170, quoting from *Hans Rees' Sons, Inc. v. North Carolina*, 283 U.S. 123, 135 (1931).

in the field of state taxation. It really seeks to apply a method which has even less validity than does "separate accounting." Even though the method has been termed throughout the briefs in this case as "separate accounting," it is really the specific income attribution method. It purports to attribute specific portions of the taxpayer's overall net income to specific locations, and to do so accurately. Shell's reliance upon the method, by whatever name it is designated, conflicts with the position which the Court has long taken on the subject. In 1920, the Court commented upon "the impossibility of allocating specifically the profits earned by the processes conducted" by a business within the borders of a state.[14] It did so in ruling against an attack on formulary apportionment. It has never ruled otherwise. Indeed, formulary apportionment has withstood every challenge that taxpayers have directed at it in Supreme Court litigation since *Underwood*.

III. THE OUTER CONTINENTAL SHELF LANDS ACT (OCSLA) IS IRRELEVANT TO THE DETERMINATION OF THE AMOUNT OF SHELL'S NET INCOME THAT IS REASONABLY ATTRIBUTABLE TO IOWA.

The method proposed by the taxpayer here is not preferable to formulary apportionment as applied by Iowa in determining the amount of Shell's total income which is reasonably attributable to Iowa. That formula does not concern itself with where in the world any non-Iowa income was earned. Such a concern is irrelevant to the reasonableness of the Iowa result. Therefore, whether

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14 *Underwood, supra* at 121.

or not any of such income was or was not earned on the OCS is likewise irrelevant to the question of whether the income which the formula attributes to Iowa is reasonable. It must follow, then, that the OCSLA itself is irrelevant to any question as to what portion of Shell's income is properly attributable to Iowa. Since the taxpayer has not questioned the reasonableness of Iowa's formulary result and has offered no proof whatsoever that that result is not reasonable, the Court should simply rule that Iowa is not precluded by the OCSLA from taxing that portion of Shell's total unitary net income which is reasonably attributable to Iowa as determined by Iowa's application of formulary apportionment to that income.

IV. THE COURT SHOULD END THE PRACTICE OF ACCORDING "SEPARATE ACCOUNTING" THE DIGNITY OF AN ACCOUNTING TERM.

The entire field of interstate taxation, starting with the unitary business principle, is plagued by misunderstanding. Much of it traces to efforts to apply scientific exactness to the field of income attribution, which is by its very nature, impervious to exactness. [15]

In applying the unitary business principle in the context of corporate income taxation, the Court has always kept before it the simple question of whether the state was making a reasonable effort to effect a fair division of the income of a multistate taxpayer. Thus, the question has always been that of whether the effort has resulted in an attribution of income to the state in a manner which produced a fair and reasonable result.[16]

15 *Ibid.*

Toward this end, the Court has always carefully avoided blessing any particular method as the preferred method.[17] In *Container,* the Court noted that variations on the theme of unitary apportionment can be acceptable so long as those variations "are logically consistent with the underlying principles motivating the unitary approach."[18] Those principles may be summed up to be that the end result must be fair and reasonable. The mere fact that the use of some other approach, such as separate income attribution (formerly, we hope, called "separate accounting"), might produce a different result is irrelevant. Adherence to the principles is the standard against which any result will be measured.

16 "Fair and reasonable" is a distillation of the Court's comments in various decisions, e.g.: "[A]n apportionment formula must, under both the Due Process and Commerce Clauses, be fair . . .," *Container, supra* at 169; "the Due Process Clause . . . [requires] . . . a rational relationship between the income attributed to the State and the intrastate values of the enterprise," *Mobil, supra* at 436-7; there must be a "rational relationship between the income attributed to the State and the intrastate values of the enterprise," *ibid;* the tax must be "fairly apportioned" and it must be "fairly related" to services rendered by the state, *Exxon, supra* at 228; the state must tax only its "fair share" of the taxpayer's income, *ibid* at 219; the tax must be "reasonably related to the activities conducted within the taxing State," *Moorman, supra* at 273; "[i]t is not shown in the present case . . . that [the method used] has produced an unreasonable result," *Bass, Ratcliff, supra* at 283; the income being taxed must be "reasonably atrributable" to in-state activities so that the taxpayer shoulders "its fair share of the burden of taxation," *Underwood, supra* at 121.

17 See *Container, supra* at 171.

18 *Ibid* at 167.

The problems that have been attributed to the unitary business principle trace largely to two things: 1) the ignoring of its fundamental purpose, which is to apportion all income that is related to the totality of the business in question, regardless of the form in which that business is conducted[19]; and 2) confusion as to the meaning of terms. Therefore, Amicus will here seek to clarify at least some aspects of the unitary business principle, as seen by the MTC, by defining terms and discussing them.

SPECIFIC INCOME ATTRIBUTION, in the stead of "Specific Accounting" or of a form of "separate accounting": means the tracing of gross income and related expenses to specific locations, thereby assigning the resulting net income specifically to those locations. It involves the attribution of net income on the basis of sourcing rules[20] as opposed to the attribution of net income on the basis of formulary apportionment . A taxpayer's attempt to use the concept to attribute income among its various locations was rejected by the Court in *Butler Bros. v. McColgan*.[21] The Court referred to the system used there as "separate accounting" and has continued to use that term over the years in reference to what we here propose to call specific income attribution.[22]

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19 ". . . the form of business organization may have nothing to do with the underlying unity of diversity of business enterprise." *Mobil, supra* at 440 (1980).

20 Sourcing rules may be based on the location of activities or properties or on the domicile of the entity.

21 315 U.S. 501 (1942).

22 It is common to attribute non-business income specifically. Thus, for example, UDITPA specifically attributes non-business net rental income from real estate to the state in which the property is located.

SEPARATE ENTITY INCOME ATTRIBUTION, in the stead of "Separate Accounting": Means a method of attributing the income of a taxpayer corporation among the various jurisdictions in which it conducts its business. It is a method which uses the books and records of the corporation to determine the income to which formulary apportionment applies in order to achieve its income attribution purpose. Since the books and records of a corporation invariably reflect only its own separate activities, the term "sparate entity accounting" has often been used interchangeably with the term "separate accounting." But neither constitutes the applying of accounting principles and neither necessarily produces accurate income attribution results.

The development of unitary combination and the ultimate confirmation of its validity by the Court in *Container*[23], have given rise to the above indicated definition of separate entity income attribution ("separate accounting") in the context of an alternative to unitary combination. Thus, unitary combination is defined as the application of the unitary business principle to two or more corporations engaged in the same unitary business; by contrast, separate entity income attribution limits its horizons to a single corporation.

In the briefs in the instant case as well as in the other pending case of *Shell Oil Co. v. Florida Department of Revenue*[24], the parties use the term "separate accounting." This reflects the imprecise nomenclature which has evolved. Both Iowa and Florida apply separate entity ac-

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23 *Supra*.

24 No. 86-1593.

counting in that neither state looks beyond the single corporate entity to determine a taxpayer's taxable income, i.e. neither state applies unitary combination. What the parties are really describing is specific income attribution, since they are referring to a specific item of income, namely that income which Shell claims to have had its source on the Outer Continental Shelf. No separate entity accounting applies here since the same corporation, Shell, is conducting activities both in Iowa and on the OCS. Formulary apportionment is, therefore, the proper method by which to determine what portion of that corporation's income is attributable to Iowa.

Shell seeks to attribute a portion of its income by means of what it calls "separate accounting" but which is nothing more than specific income attribution. In applying the method, Shell purports to trace specific gross income and specific related expenses to a specific location, the OCS, thereby assigning specific net income to the OCS. (We will not here duplicate the excellent discussion, in Iowa's brief, of the inconsistent manner in which Shell has sought to do this; that very inconsistency on the part of Shell constitutes a demonstration in itself of the impossibility of accurately attributing net income to specific locations.) In "skewing [facts] to resolve all doubts"[25] in its favor, Shell simply ignores expenses which it might have been expected to attribute to the OCS had it really believed in the system which it purports to use.

The Court has, from time to time, used other terms which have included the word "accounting." It has re-

25 The "skewing" wordage is derived from *Container, supra,* at page 183, in which the Court referred to a "separate accounting analysis" which had been involved in *Hans Rees' Sons,* supra.

ferred to "formal geographical or transactional accounting" in *Container*[26], to "separate geographical accounting" in *Mobil*[27] and in *Exxon*[28] and to "separate functional accounting" in *Exxon.*[29] Amicus submits that the substitution of the word "attribution" would be preferable in every such instance; and that the elimination of the word "formal" is equally desirable. "Formal," as so used, implies that the method being applied is one that reflects generally accepted (i.e. "formal") accounting principles. In fact, the method does nothing of the kind.

The "separate accounting" which Shell prefers here is nothing more than one of the various "internal accounting techniques [which a company may use and which] are not binding on a State for tax purposes"[30]. The Court has always rejected such techniques when proffered as alternatives to formulary apportionment. But taxpayers refuse to believe it because of their mystical confidence in the efficacy of the word "accounting" to tip the scales in their direction. The Court might well relieve them of their misconception if it would resort to the use of income attribution language in the stead of "accounting" language in referring to the concepts in question.

UNITARY BUSINESS: Means a business the activities of whose elements (members, in the case of a multicorporate structure) are so functionally integrated as to

26 *Supra* at 164.

27 *Supra* at 438.

28 *Supra* at 215.

29 *Ibid* at 218, 223, 225 and 226.

30 *Ibid* at page 221.

be engaged in a single economic enterprise. Questions as to whether those elements are unitary will generally arise when the elements consist of separate legal entitles, e.g., separate corporations.

A corporation may be engaged in two or more discrete unitary businesses, thereby having two classifications of income within the single corporate structure. In such instances, it may be appropriate to apply the specific income attribution concept to determine what portion of the corporation's total income is attributable to each of the businesses and then to apply formulary apportionment to each of those businesses in order to determine how much of the income of each should be attributed to the states in which the corporation does business. In applying apportionment under such circumstances, it is necessary to attribute property, payroll and sales specifically to each of the discrete businesses.

Although this does not happen often[31], the states are experiencing increasing numbers of instances in which a question arises as to whether a taxpayer consisting of a single corporation is engaged in more than one diserete business.[32]

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31 In *Exxon, supra,* the taxpayer, a single corporation, attempted to separate its exploration, production and refining functions, which were all performed out-of-state, from its marketing function, part of which was performed in-state. The Court rejected the attempt.

32 See, for example, *Silent Hoist & Crane, Inc.* v. *Director of Taxation,* 100 N.J. 1, 494 A.2d 775 (1985), in which a corporation failed to convince the New Jersey Supreme Court that its various multidivisional activities were not unitary. And see Proposed California Diverse Business regulation

(Continued on following page)

Historically, a prerequisite to qualification as a unitary business has been common ownership or control, either directly or indirectly, of more than fifty percent of the voting stock of related corporations. In *ASARCO, Inc. v. Idaho State Tax Commission*[33], the Court held that ownership of more than fifty percent of the voting stock was not sufficient where there was no control. This has left open the question as to whether control provides a sufficient ownership basis even if ownership amounts to fifty percent or less.

Unities of operation[34] and of use[35] will always be pres-

(Continued from previous page)

25120(b), the first sentence of which reads: "A corporation subject to taxation may be engaged in more than one 'trade or business'." MTC Review, December 1987. But see *Appeal of P and M Lumber Products, Inc.*, Calif. St. Bd. of Equal., June 27, 1984 CCH 400-902, P-H 13, 112-W, in which the Board held that there were insufficient unitary ties between a lumber business division and a cattle business division of a single corporation to sustain a contention by the taxpayer that it conducted only a single unitary business. See also *Appeal of Mole-Richardson Company*, Calif. St. Bd. of Equal., October 26, 1983, CCH 400-652, P-H 13, 109-H, in which the Board held that a closely-held corporation was operating a number of separate enterprises.

33 458 U.S. 307 (1982).

34 Unity of operation means unity of staff administrative service functions, such as centralized purchasing, advertising, accounting, personnel policies and management, which further the integration of operations of the entities in question. See *Edison California Stores* v. *McColgan*, 183 P.2d 16, 20 (1947).

35 Unity of use involves unity of line functions, such as a centralized executive force and a centralized system of operation, all of which contribute to the functional integration of the activities of the entities in question. See *Edison California Stores, supra* at 20. Intercompany sales can also be indicators of unity of use, although the absence of such sales does not necessarily mean that such unity does not exist. See *Container, supra* at 176.

ent when functional integration exists among the related corporations.[36] So will the elements of dependency and contribution, in that the various entities will derive mutual benefits from their business relationships with each other as members of the unitary business.[37] In such cases, substantial flows of value[38] will be taking place. In sum, the unitary business will be benefitting from "functional integration, centralization of management, and economies of scale."[39]

UNITARY COMBINATION: Means the procedure under which unitary apportionment is applied. It involves the preparation of a so-called "combined report" in which the activities (e.g., property, payroll and sales) of a group of corporations that are engaged in a unitary business are taken into account to arrive at a formulary percentage. That percentage is then applied to the entire income of the unitary group to determine the amount of income that should be attributable to a state for corporate tax purposes.

UNITARY BUSINESS INCOME: Means all income derived by the unitary business from the conducting of its business activities. Such income is apportionable income. It includes dividends from investments made to further the purposes of the unitary business, e.g., to ensure a market for its goods or services, to ensure a source of raw ma-

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36 The so-called "three-unities" test of ownership, operation and use was established in *Butler Bros. v. McColgan, supra.*

37 The so-called "contribution or dependency" test traces to *Edison California Stores, supra.*

38 See *Container, supra* at 178.

39 *Ibid, supra* at 179.

terials, and/or to ensure availability of transportation, when needed, for its products. It includes interest received on short-term investments of money being held for purposes of the unitary business, e.g., for expansion of its facilities, for purchases of raw materials at anticipated advantageous market prices, for research and development. Amicus contends that such income includes royalty income from patents, copyrights and trademarks developed and/or owned by the unitary business in connection with the operation of that business; and that in none of these instances need the source of the income be engaged in the unitary business with the taxpayer as a prerequisite to that income's being included in the taxpayer's apportionable business income.[40]

The determination of the amount of the taxpayer's apportionable net business income is made by reference to the activities of the entity which is the source of the dividends, interest or royalties. Of course, some income may be received from a corporation which, were it not for a lack of unity of ownership, would be unitarily combinable with the taxpayer. Such income is clearly unitary income to the taxpayer. Had unity of ownership existed along with unities of operation and use so that functional integration existed and combination could have been applied,

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40 Attempts are often made to separate out from apportionable business income that income that has been received from intangibles, the rationale being that that income is derived from some outside source, e.g., dividends received from an unrelated corporation or interest received on debentures issued by an unrelated corporation. But Amicus contends that this is an erroneous approach, and that one should look only to the questions of why the investments were made and how they enhance the operation of the taxpayer's business.

that corporation's income would have been combined into the apportionable net business income base of the entire unitary business. Amicus contends that the mere absence of unity of ownership does not change the unitary nature of income received from that corporation by the parent even though that income now comes to the parent in the form of dividends.[41]

NONBUSINESS INCOME: Means all income other than unitary business income.[42]

CONSOLIDATION: Means the determination of the tax liability of the taxpayer by combining the activities of all commonly owned, whether directly or indirectly, corporations to determine the apportionment percentage of the group and then applying the resultant in-state percentage to the total income of the group. It differs from unitary combination in that it is based solely upon ownership without regard to whether the corporations are engaged in a unitary business. (For federal income tax purposes, the percentage of common ownership that is required is 80%. A consolidated federal income tax report does not, therefore, include unitary corporations that are more than 50% but less than 80% commonly owned.) Consolidation affords the taxpayer the advantage of being able to offset losses in some corporations against profits in others. Due Process considerations dictate that, absent a unitary relationship as evidenced by functional integration among the commonly owned corporations that are included in the consolidated report, a state cannot constitutionally require consolidation. It can, though, give the taxpayer the option to use consolidation.[43]

41 Many states now exempt a large percentage of such dividends from taxation, however.

42 See Section 1.(e) of the Uniform Division of Income for Tax Purposes Act (UDITPA).

V. THE POSITIONS OF IOWA AND FLORIDA ARE COMPATIBLE; NEITHER SEEKS TO TAX ANY PORTION OF SHELL'S INCOME THAT IS NOT REASONABLY ATTRIBUTABLE TO ACTIVITIES CARRIED ON WITHIN ITS BORDERS.

Since the same taxpayer, Shell, has pending before the Court another case which involves the same type of claim against Florida[44] with respect to its alleged OCS income as is at issue herein, it is important that there be no misunderstanding here as to the possible effect of the decision in this case on the Court's subsequent decision in the Florida case. The two states arrive at substantially similar results by routes that are substantially similar.

Iowa applies its single factor formula to the worldwide income of Shell to determine what portion of that income is attributable to Iowa.

Florida applies the same single factor formula to the worldwide income of Shell to determine what portion of that income is attributable to the fifty states of the United States. It then applies its own three-factor formula to

43 Arkansas affords the taxpayer this option, allowing the application of the formula to consolidated federal taxable income. Oklahoma allows the taxpayer the option to apply the formula to only those members of the federal consolidated group which have property, payroll and/or sales in the state. Hawaii gives the taxpayer the option of applying the formula to only those members of its unitary business which have a taxable nexus within the state.

44 *Shell Oil Company v. Department of Revenue, State of Florida*, No. 86-1593.

the latter fifty-state income to determine what portion of it is attributable to Florida. If it used the Iowa formula in the latter exercise, the result would be identical to that reached by Iowa.[45]

Assume, for example, that one per cent of Shell's total sales are made into each of the fifty states. Iowa's formula would attribute one per cent of Shell's income to Iowa. Florida would use the same formula to determine that 50% of Shell's income is attributable to the fifty states. If it used Iowa's formula in the second step, it would now determine that one fiftieth of the fifty-state income was attributable to Florida, which would also be one per cent.

At the second step, Florida takes into account two other activities in addition to those of sales. It takes the route which the states more commonly apply[46] by using a three-factor formula which includes property and payroll as well as sales. The Florida formula, like those of eight other states,[47] consists of a 50% sales factor, a 25% property factor and a 25% payroll factor. If one per cent of Shell's total property and one per cent of its total payroll were in Florida, then the result would still be the

45 Of course, Florida has the right to use its own formula to achieve a reasonable result. ". . . the Court has refused to impose strict constitutional restraints on a State's selection of a particular formula." *Moorman, supra* at 273.

46 All income tax states except Iowa make available to the taxpayer a three-factor formula consisting of property, payroll and sales. The weighting of the factors varies somewhat among the states.

47 Connecticut, Illinois, Kentucky, Massachusetts, New York, Ohio, West Virginia and Wisconsin. See Multistate Tax Commission Review, June 1987, page 11, footnote 4.

same; and one per cent of Shell's total income would be attributable to Florida just as would be the case if it used the Iowa formula throughout. If its property and payroll percentages were smaller, then a smaller percentage of Shell's total payroll would be attributable to Florida; if they were greater, then the greater attribution would be constitutionally valid so long as the result was not unfair,[48] unreasonable,[49] or grossly distorted.[50]

The result is that, in initially applying the single (sales) factor formula to all of Shell's income, both states include all of Shell's sales, including any that may be made on the OCS, in the denominator of the sales factor; and that neither of the states includes any of the OCS sales in the numerator of that factor.[51]

Shell would have the Court think otherwise. It claims that "under Iowa's reading of the OCSLA each of these jurisdictions [i.e. the states that use formulary apportionment] would be free to tax Shell's OCS income by including it in the apportionable base." (Shell brief at 8.) In fact, if every state followed either Iowa's or Florida's practice, no OCS income would be taxed. Thus, the formulas have the required internal consistency required by this Court.[52] In the example given above, only 50%

48 *Container, supra* at 164.

49 *Bass, Ratcliff, supra* at 283.

50 *Norfolk and Western Railway Co., supra* at 326.

51 Neither does Florida include any non-Florida sales in the numerator of the sales factor of its three-factor formula in the second stage of its calculation.

52 See *Container, supra* at 169.

of Shell's income would be attributed among all of the states; any OCS income would fall into the category of income that had been formularily excluded from taxation by any state, i.e. the other 50%. Thus, Shell is inaccurate again when it says (Shell brief at 15) that Iowa's position would allow the states collectively to do what it concedes that no state can do individually. As shown in the example, each state could tax only its 1%, and the group of states could tax only 50% of Shell's worldwide income; the remaining 50% would be excluded from taxation by any state.

VI. THE COURT SHOULD REJECT THE INTENDED EFFECTS OF SHELL'S OUT-OF-CONTEXT QUOTATIONS AND MISLEADING IMPLICATIONS.

Shell quotes Exxon out of context, saying (Shell brief at 23) that "it is clear, as this Court has recognized, that apportionment 'subject[s] to taxation * * * income derived from the extraction of oil and gas located outside the State'." The full sentence reads, "The second issue is whether the Due Process Clause permits a State to subject to taxation under its statutory apportionment formula income derived from the extraction of oil and gas located outside the State which is used by the refining department of the taxpayer, or whether the State is required to allocate such income to the situs state."[53] The "recognition" that Shell represents does not exist. This Court simply rejected Exxon's contention that separate accounting was preferable to formulary apportionment as a means of obtaining "a rough approximation of the income that is reasonably related to the activities conducted within the taxing State."[54]

53 *Exxon, supra* at 210.

Shell quotes *Moorman* out of context by extracting only part of a sentence from that decision. The full sentence is: "Yet even were we to assume that the Illinois activities made some contribution to the profitability of the Iowa sales, appellant's claim that the Constitution invalidates an apportionment formula whenever it may result in taxation of some income that did not have its source in the taxing State is incorrect."[55] That is a far cry from any recognition by the Court that, as Shell claims, "apportionment 'may result in taxation of some income that did not have its source in the taxing State'." (Shell brief at 23).

In reference to n. 1 of J. Hellerstein, State Taxation, at p. 478, Shell correctly quotes a Florida case cited in that note that "[i]n * * * apportionment, the taxpayer's normal or business income is mathematically divided among the various jurisdictions in which it does business to determine the measure of local tax." (Shell brief at 23.) But, contrary to Shell's implication, the Iowa formula does exactly that, attributing outside of Iowa, and therefore potentially to the OCS, any income not reasonably attributed to Iowa by the formula.

Shell justifies its contention that Iowa is taxing some of its OCS income by the fact that the result is an increase in Shell's tax to Iowa over the separate accounting approach. (Shell brief at 24.) But, of course, the

54 *Ibid* at 223, quoting from *Moorman, supra* at 120.

55 See *Moorman, supra* at 272.

opposite would be the case were Iowa in a start-up situation which, over a period of start-up years on the OCS, might well result in a lesser tax liability to Iowa as the result of the application of the Iowa formula to Shell's total income which the huge start-up expenses would normally reduce during those years. It is not without significance that no other oil company has, to our knowledge, filed a brief in this case. That is tacit recognition of the fact that they are likely to incur future start-up expenses on the OCS and that they do not want those expenses to be excluded from the determination of their apportionable income base for the formulary apportionment purposes of the various states. Their concern is appropriate from both a practical and a legal perspective. The proper application of the apportionment formula dictates that all of the corporation's income and activities, including any on the OCS, be taken into account by every state in the determining of the net income base to which that state applies its apportionment formula and in determining the denominators of the factors in that formula.

Neither Iowa nor Florida is exercising any sovereignty over the OCS in applying formulary apportionment to Shell's income, Shell's contention to the contrary notwithstanding (Shell brief at 25). Neither state goes near the OCS. It does not know and cannot know how much or which of Shell's income comes from the OCS; neither does nor can Shell know. Nor does either state care about the source of any of Shell's income that may be attributable to locations outside its borders. It cares about

only that portion of Shell's total income that is reasonably attributable to activities within its borders. Therefore, neither state is applying its taxation laws to the OCS nor exercising any jurisdiction over the OCS.

It is only political and taxing jurisdiction that is precluded by OCSLA. Representative Boggs made that clear when, during congressional debate, he said that the law "strikes out any participation by the States in the taxing of these resources."[56] Resources are capable of being located specifically, unlike the net income of a multistate or multinational corporation like Shell. A tax on those resources would clearly violate the statute. Neither Iowa nor Florida seeks to apply such a tax. Each seeks to tax only that portion of Shell's total income which is reasonally attributable to activities within the state's own borders. It should be allowed to continue to do so without concern for Shell's spurious OCS contentions.

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56 99 Cong. Rec. at 2572.

CONCLUSION

Shell's references to an irrelevant Federal Act, OCSLA, and to an incorrectly named non-accounting term should not blind the Court to the effect which Shell seeks to accomplish here, namely the emascalating of formulary apportionment and the overturning of nearly seventy years of consistent rulings by the Court. The decision of the Iowa Supreme Court should be affirmed.

Respectfully submitted,

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October Term 1987

Shell Oil Company, Appellant

v.

The Iowa Department of Revenue, Appellee

On Appeal from the Supreme Court of Iowa

Brief for Department of Revenue State of Florida as Amicus Curiae in Support of Appellee

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Interest of Amicus

The Department of Revenue, State of Florida, (Florida) submits this brief pursuant to Rule 36 of the Rules of this Court. Written consent of both parties is attached.

Florida is the appellee in Shell Oil Company v. Department of Revenue, State

of Florida, Case No. 86-1593[1]. Shell has suggested that this Court consolidate Shell v. Iowa and Shell v. Florida or that Shell v. Florida be held pending a disposition in Shell v. Iowa. 86-1593 Appellee's Supp. Memo 3 & 4. Florida opposed both suggestions because of the delay and because the consolidation would permit Shell to obfuscate the single legal issue presented in Shell v. Florida. Inasmuch as the disposition of Shell v. Iowa may impact on Shell v. Florida, Florida submits this brief. Moreover, Shell in its Brief for the Appellant herein, has brought Shell v. Florida into this proceeding (Appellant's Br. 12, 44).

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[1] The case is pending this Court's decision on whether to grant jurisdiction. For convenience and clarity it will be referred to as Shell v. Florida and the case herein before this Court will be referred to as Shell v. Iowa.

Summary of Argument

With the enactment of the Outer Continental Shelf Lands Act (OCSLA), 43 U.S.C. 1331, et seq, Congress codified a federal enclave outside of any state boundary over which the federal government has exclusive jurisdiction and over which "State taxation laws shall not apply". This controversy involves state taxation of the income of a multijurisdictional corporation which conducts unitary business activities in the various states and on the Outer Continental Shelf (OCS) as well.

Shell herein asserts that OCSLA mandates the use of separate accounting rather than formula apportionment to determine an amount of income it perceives as attributable to its business activity of producing oil and gas on the OCS which amount is protected under the federal geographic preemption. The

particular separate accounting method urged by Shell requires that the federal income tax concept of gross income (founded on realized gross receipts arising from actual sales) be rejected and that artificially computed market "prices" at the wellhead be substituted for actual gross receipts in Shell's hybrid separate accounting method. Shell urges that an amount of "earned income" so constructed must be deducted from the preapportionment federal taxable income base used to attribute income by the apportionment method to a taxing state.

Congress has imposed a federal tax on income which is embodied in the Internal Revenue Code (IRC). In that imposition, Congress precisely defined the federal tax accounting method, the concept of gross income, the attributable expenses and finally the resultant tax

base, federal taxable income. The various states including Florida and Iowa, with varying degrees of precision, have adopted federal taxable income, together with its underlying concepts as the starting point in determining each respective state's income tax base thus embracing the underlying federal determinations of gross income, attributable expenses and net income.

Moreover, federal determinations are also used by Florida and Iowa in determining the sales (gross receipts) fraction used to divide the single multijurisdictional federal taxable income base by apportionment. Both states use apportionment rather than separate accounting as the preferred method of dividing that income. In computing the sales fraction states attribute federally recognized gross receipts from actual consummated sales on

a destination basis.[2] Under Shell's hybrid method of separate accounting, gross receipts are attributed to the situs of production on an origin basis.

Shell asserts that the states bear the burden of establishing an "exception" within OCSLA to permit determination of a state tax base determined by federal taxable income. Florida asserts that the burden rests with Shell to etablish that the Congress mandated Shell's hybrid separate accounting method which mandate the states deny exist.

Argument

The Preapportionment Tax Base

As Shell concedes, both Florida and

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2 The use of the destination rule for attributing the receipts from sales of goods is a sine qua non, if the claim of the market States to a share of the tax base is to receive meaningful recognition. J. Hellerstein, State Taxation, 338, (1983).

Iowa adopt federal taxable income as the precise starting point in computing the preapportionment income tax base.[3] Congress precisely defined the federal tax accounting method, the concepts of gross income, the attributable expenses and the resultant tax base, all of which are prerequisites in determining federal taxable income. Among these underlying federal concepts is the concept of gross income.

Gross Income

Under generally accepted accounting principles and, federal and state income tax law, for purposes of establishing gross income used to determine the initial tax base, a consummated sale is generally recognized as a condition precedent to the realization and

---

3 Both states by separate statutes make state adjustments to this preapportionment tax base. These adjustments are not relevant here.

recognition of gross income. There is no provision in OCSLA or its legislative history which mandates the contrary or any deviation from this federal standard.

Under generally accepted accounting principles (GAAP), income is normally not considered as existing before it is fully realized.

> Realization. The process of converting noncash resources and rights into money or, more precisely, the sale of an asset for cash or claims to cash ....
>
> ...the earnings process occurs throughout the various stages of production, sales and final delivery of the product. However, the difficulty in measuring the precise rate at which this earnings process is taking place has lead accountants to conclude that income should normally be recognized only when it is fully realized. Realization generally implies that the enterprise producing the item has completed all of its obligations relating to the product and that collection of the resulting receivable is assured beyond reasonable doubt.

Delaney, Adler, Epstein, and Foran, GAAP-Interpretation and Application, pp. 44, 45 (1985 ed.)

The identical realization concept is contained in federal income tax law.

> Section 61(a) incorporates a realization requirement in the definition of gross income. The section refers to "income from whatever source derived," "Gross income derived from business," and "Gains derived from dealings in property." To be taxed, gains must be realized, that is, sufficiently fixed and definite to be treated as gross income. Realization generally connotes a sale of an asset for cash or its exchange for other property. As a result of the realization requirement, the income tax taxes transactions.
>
> ****

In Helvering v. Horst, [3] decided shortly after Helvering v. Brunn, the Supreme Court amplified its definition of the realization requirement as the taxable event that occurs "when the last step is taken by which [the taxpayer] obtains the fruition of economic gain which has already accrued to him." The Court also explicitly characterized the realization requirement as one "founded on administrative convenience."

Solomon, Gross Income-Conceptual Aspects, p. A-30, 31 (1986).

Thus, no gross income is realized prior to the consummation of an actual sale. The concept of "earned income" attributable to the activity of production does not exist either under GAAP or under the Internal Revenue Code (IRC) as production must occur before an actual sale can be consummated, hence no gross income then exists.

The Supreme Court of Florida stated as follows:

> In the case at bar, this realization occurred at the time of sale. Clearly, no realization of income occurred at the wellhead, despite Shell's aassignment of an artificial wellhead price to the oil, because Shell received no actual economic gain from any "sale, exchange, or other disposition of property" at that point. s. 220.02(4)(a). Rather, realization occurred at the time Shell sold the oil in the states because only at that time did Shell derive any actual economic gain.

Shell Oil Co. v. Dept. of Revenue, 496, So.2d 789, 791 (Fla. 1986) (86-1593 J.S. App. 1-1).

Where no sale has occurred, no gross income is realized or recognized and the costs of production are merely assigned as the value of property held in inventory. This is true of motor vehicles produced in Japan and Germany, of diamonds extracted in Africa and of oil extracted in the Middle East or within a given U.S. jurisdiction.

The value of extracted petroleum products measured at the wellhead based upon artificial "prices" is used merely as a lesser included mathematical computation specifically for the limited purpose of determining the allowable depletion deduction authorized by sections 613 and 613A of the IRC and is not used to determine federal gross income.

"Earned income" attributable to production is non-existent income under these concepts. Shell construes the OCSLA to authorize the recognition of such non-existent by inference. Had Congress intended such a radical departure from established federal income tax concepts and generally accepted accounting principles, it would have so provided clearly and unequivocally.

Transfers Between Divisions

Mere internal transfers of crude oil between Shell's production division and Shell's marketing division are non-events in determining gross income for federal tax accounting purposes, regardless of assignment of artificial "prices" to such transfers for internal purposes or for determining amounts due lessors under oil leases.

As the United States has noted:

> Florida has conceded, as it must, that Shell's sales of OCS oil to independent third parties, if completed on the OCS itself, are immune from state income taxation. See J.S. App. 1-8. It might be argued from this premise that a corporation's sales of OCS oil to a related corporation, if completed on the OCS itself, would likewise be immune from state income taxation, provided that the sales comported with the norm of unrelated parties dealing with each other at arm's length. If that is so, Shell might contend that a different result should not obtain merely because the transfer occurs (as here) between divisions of a unitary corporation rather than between subsidiaries of a parent corporation. It is of course well established under the federal tax laws that, "while a taxpayer is free to organize his affairs as he chooses, nevertheless, once having done so, he must accept the tax consequences of his choice, whether contemplated or not." Commissioner v. National Alfalfa Dehydrating & Milling Co., 417 U.S. 134, 149 (1974).

86-1593 U.S. Br. 16.

Moreover, only separate legal entities are recognized as taxpayers in

the IRC as shown by the following definitions in ss. 7701(14) and (1) of the IRC:

> (14)TAXPAYER-The term "taxpayer" means any person subject to any internal revenue tax.
>
> (1)PERSON-The term "person" shall be construed to mean and include an individual, a trust, estate, partnership, association, company or corporation.

Thus the IRC recognizes only legal entities and not divisions of a single corporation. No contrary recognition is visible in OSCLA. To bifurcate a corporation would be repugnant to these federal provisions. Moreover, for income tax purposes states are bound to respect the separateness and wholeness of each entity[4]. It is well established that the

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[4] For an exposition of similar state application, See Intersate Finance Corporation v. Wisconsin Department of Taxation, 137 N.W.2d 38, 44 (1965).

entity concept is essential to the protection provided by the Due Process and Equal Protection Clauses in the taxation of income.

Burden of Proof

Shell's argument conclusively presumes that OCSLA prohibits the inclusion of Shell's federal taxable income in its entirety in the preapportionment income tax base. (Appellant's Br. 16, 21).

When claiming an erosion of the initial tax base, the burden rests with the taxpayer to point to an applicable statute and demonstrate he comes within its terms. New Colonial Ice Co. v. Helvering, 292 U.S. 435, 440 (1934); and Tax Court Rule 142. The burden of proof is intertwined with the presumption that the tax administrator's determination of a deficiency in tax is prima facie correct. Welch v. Helvering, 290 U.S.

111, 115 (1933). This Court has squarely placed the burden of proof on the taxpayer which conducts a unitary business and claims immunity from a tax. Container Corp. of America v. Franchise Tax Bd., 463 U.S. 159, 175 (1983).

The burden of proof rests with Shell. In order to sustain its argument, Shell must establish either (1) the existence of a total immunity which transcends all geographic boundaries or (2) that the apportionment method used by the state to attribute income to that state is so unreasonable that an increment of total federal taxable income clearly sitused on the OCS was actually taxed by that state. Shell has failed to carry its burden to establish either.

It is well settled that apportioned state income taxes have afforded proper geographic attribution of a portion of federal taxable income to the

apportioning state.

Exclusion of an increment of income from the preapportionment tax base was addressed by this Court in Mobil Oil Corporation v. Commissioner of Taxes of Vermont, 445 U.S. 425 (1980).

> ... [The] appellant's principal objective was to achieve the subtraction of the asserted nonapportionable income from the preapportionment tax base; .... p. 432.

Therein, this Court ruled:

> It has long been established that the income of a business operating in interstate commerce is not immune from fairly apportioned state taxation. p. 436.
>
> The argument that the source of the income precludes its taxability runs contrary to precedent. In the past, apportionability often has been challenged by the contention that income earned in one State may not be taxed in another if the source of the income may be ascertained by separate geographical accounting. The Court has rejected that contention so long as the intrastate and

extrastate activities formed part of a single unitary business. See Butler Bros. v. McColgan, 315 US 501, 506-508, 86 L Ed 991, 62 S Ct 701 (1942); Ford Motor Co. v. Beauchamp, 308 US 331, 336, 84 L Ed 304, 60 S.Ct. 237 (1939) cf Moorman Mfg. Co. v. Bair, 437 U.S., at 272, 57 L.Ed.2d 197, 98 S.Ct. 2340. In the circumstances, the Court has noted that separate accounting, while it purports to isolate portions of income received in various States, may fail to account for contributions to income resulting from functional integration, centralization of management, and economies of scale. Butler Bros. v. McColgan, 315 US, at 508-509, 86 L Ed 991, 62 S Ct 701. Because these factors of profitability arise from the operation of the business as a whole, it becomes misleading to characterize the income of the business as having a single identifiable "source". Although separate geographical accounting may be useful for internal auditing, for purposes of state taxation it is not constitutionally required. p. 438.

Thus, applying this Court's constitutional criteria, the taxing state may refuse to exclude an increment of unitary income from the preapportionment

tax base and may reject separate accounting. Inasmuch as Shell's "OCS income" is concededly unitary, no constitutional hurdle exists in dividing total income by apportionment.

Purpose of OCSLA and Its Effect

This Court has at least twice noted the purpose of OCSLA:

> [T]he purpose of the OCSLA was to assert the exclusive jurisdiction and control of the Federal Government of the United States over the seabed and subsoil of the outer Continental Shelf and to provide for the development of its vast mineral resources.

Gulf Offshore Co. v. Mobil Oil Corp., 453 U.S. 473, 479, n.7 (1981). The OCSLA was intended to provide "for the orderly development of offshore resources." United States v. Maine, 420 U.S. 515, 527. Florida respectfully submits that this construction of purpose does not require total immunity of all values created upon the OCS. The statutory purpose to regulate does not require

total immunity. This power to control, restrict or limit depends upon the nature of the subject matter and the governing statute. Where the purpose of a statute is to mandate exclusive federal jurisdiction over a specific geographic area to regulate the orderly development of that area, the statute does not require absolute prohibition of authority exercised in respect of subsequent business activities (sales consummated) without that specific geographic area. Compare City of Malden v. Flynn, 61 NE 2d 107 (Mass. 1945). Total immunity cannot arise by inference where the defined purpose of the statute can be accomplished without existence of the asserted total immunity.

Shell cites a number of decisions which address a statutory grant of total immunity. These are distinguishable in that totality of immunity was required to achieve the defined purpose and the

total immunity granted was expressly stated in the governing statute, which circumstances are absent in OCSLA.

State Apportionment

This Court, in its decisions which judged the viability of a given state apportionment formula used to determine that jurisdiction's share of the federal taxable income of a multijurisdictional taxpayer has addressed solely the question of whether the resultant state tax base is fairly attributable to business activities within that jurisdiction or that "the taxing power exerted by the state bears fiscal relation to protection, opportunities and benefits given by the state".[5] Thus, this Court has focused only on the construction of the instate result.

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[5] Wisconsin v. J.C. Penney Co., 311 U.S. 435, 444 (1940).

Florida suggests that an examination of the "instate" result of any other jurisdiction which contributes to the denominator of an apportionment fraction, while not previously deemed controlling, may be expositive.

Consummated Sales - Iowa

The following hypothetical example illustrates the assignment effected by Iowa's apportionment method:

Sales consummated in:	Federal Gross Receipts
Iowa	100,000
Nebraska	100,000
Texas	200,000
Oklahoma	100,000
OCS	200,000
All other states	300,000
Total Sales (Gross Receipts)	1,000,000

Assignment within Iowa

$\frac{100,000}{1,000,000}$ = 10% of federal taxable income[6]

Iowa uses sales (federal gross receipts) to apportion federal taxable income. The

---

6 modified by state adjustments.

formula is sales (federal gross receipts) in Iowa divided by sales everywhere. The situs of a sale is based on destination. Almost all of the 45 states apportion income using sales (federal gross receipts) as part of the apportionment factor to determine the situs of a sale based on destination. In the above example, the total sales (federal gross receipts) of 1,000,000 of which 100,000 were destined within Iowa results in a 10% factor used by Iowa to determine the portion of federal taxable income assigned within that state. However, this does not fully explain the effect of the denominator.

The denominator includes both sales having destinations within Iowa and sales having destinations without Iowa. Using the above examples, 90% of the total sales apportioned are assigned without Iowa. While there is no purpose (for

Iowa tax administration) to separately detail each specific "other jurisdiction" to which each portion of these "other sales" are assigned, an analysis of the 90% reciprocal is shown as follows:

Effect of Denominator

Jurisdiction	Federal Gross Receipts	Assignment Percentage
Nebraska	100,000 =	10%
Texas	200,000 =	20%
Oklahoma	100,000 =	10%
OCS	200,000 =	20%
All other states	300,000 =	30%
Assignment without Iowa		90%
Plus Assignment within Iowa		10%
Total assignment by denominator		100%

From the foregoing, 90% of the total consummated sales are assigned without Iowa, on a destination basis. It is fairly easy to compute that portion of those sales assigned to a given jurisdiction other than Iowa using the example above. For example, the $200,000 of sales which were consummated by delivery on the OCS are constructively

assigned without Iowa because of the sales destination on the OCS. The clear effect of the denominator used by Iowa is to assign to the OCS that portion of federal taxable income which is attributable to sales consummated on the OCS. Thus, by the denominator effect, Iowa constructively recognizes the exclusive federal jurisdiction over the OCS.

To demonstrate the resultant tax base attributed to any jurisdiction which contributes gross receipts to the denominator in this hypothetical example, assume the federal taxable income computation is as follows:

Net Income

Total sales (Gross Receipts)	$1,000,000
Less: Costs and Expenses[7]	900,000
Federal Taxable Income	$ 100,000

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[7] Costs and expenses are those deductible in determining taxable income under the I.R.C.

Assignment to Iowa by apportionment is computed as 10% of $100,000 or $10,000. Assignment of a portion of federal taxable income to the OCS by the denominator effect is computed as 20% of $100,000 or $20,000. From the perspective of this hypothetical example, it is clear that income fairly attributable to business activities on the OCS has been determined consistent with the concept of exclusive federal jurisdiction.

Consummated Sales - Florida

Shell attempts to distinguish between the Iowa accommodation in respect of the income attributable to Shell's activities on the OCS and that conceded by Florida (Appellant's Br. 11, 12). This distinction is without a difference since only the method differs. The portion of federal taxable income which is thus deemed attributable to the OCS is

precisely the same.

Expressed in terms of the hypothetical example, supra, with "Florida" being substituted for Iowa, the calculation is as follows:

OCS sales (20%)	$200,000
Assigned "Costs and Expenses":	
$900,000	
x 20%	180,000
Portion of federal taxable income deemed attributed to OCS	$ 20,000

Florida first identifies the precise amount of sales which are consummated by delivery on the OCS. Then a separate apportionment using the ratio of OCS sales to total sales "everywhere" is applied to the total "costs and expenses" "everywhere". The applicable federal "costs and expenses" are attributed to the OCS by this process and are then deducted from total OCS sales to determine the portion of federal taxable income which is considered by Florida to have been derived from the OCS.

This attribution process, using the single sales fraction as the apportionment factor, is directly mandated by specific Florida statutory provisions.

Section 220.13(1)(b)2, Florida Statutes (1972) (86-1593 Mot. to Dism. or Aff. App. 1, 1-4), provided a subtraction from the preapportionment tax base of the amount of federal taxable income attributable to "sales outside the United States". Thus, the preapportionment tax base required adjustment by a subtraction as a matter of state law.

To construct the amount of the above "foreign source" subtraction, Florida uses a single sales fraction as its apportionment factor. Section 220.15(3), Florida Statutes (1972)[8], defines

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8 The term "everywhere" in part IV of chapter 214, which is used in the computation of apportionment factor denominators, shall mean "in all states of the United States, the District of Columbia, or any political subdivision of the foregoing"; and

"everywhere" for determination of the denominator as "all states of the United States, District of Columbia, or any political subdivision of the foregoing"[9]. In recognition of the OCS as an exclusive federal jurisdiction, Florida applies the definition of "everywhere" as restricted to geographic areas within the three mile limit. Thus the portion of federal taxable income attributable to the OCS is effectively treated as "foreign sourced" and is eliminated <u>before</u> Florida apportions the

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9 The above two statutory provisions remained unaltered from their enactment in 1972 until 1983, notwithstanding the citation to the contrary in the dissenting opinion of the Florida Supreme Court.

remainder.[10]

While Florida uses a hybrid method to exclude the portion of federal taxable income attributable to the OCS from the preapportionment tax base and Iowa uses straightforward apportionment of total federal taxable income in a single computation under its statutory provisions, the result in both states is identical, in concept and in fact, and existence of an exclusive federal enclave is accommodated.

The sole distinction between Shell v. Iowa and Shell v. Florida is factual. Shell failed to establish in the record

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10 Confirmation of Florida method as applied is contained in Tropicana Products, Inc. v. Dept. of Revenue, Case No. CA-17-1799 (12th Jud. Cir. Manatee Co., Fla. November 22, 1976) aff. Per Curiam 353 So.2d 686 (Fla. 2nd DCA, 1977) (86-1593 Appellee's Supp. Br. App. 1, 1a), albeit that the Court, in recognition of the laws of mathematics, simply applied the sales ratio directly to federal taxable income.

in Shell v. Florida that Shell consummated any sales by delivery on the OCS and hence no subtraction was allowed. 86-1593 United States Br. 3.

Shell's Asserted Separate Accounting

Shell attempts to impeach Iowa's apportionment method by use of a hybrid separate accounting method. Moreover, Shell asserts that the legislative history of OCSLA alone impeaches the use of apportionment which assertion Florida denies. Florida asserts that generally separate accounting cannot impeach the apportionment method and further that Shell's hybrid separate accounting method incorporates additional weaknesses which compound the inherent weakness of the fundamental separate accounting method itself. Apportionment is the method of choice used by almost all taxing states to divide income among jurisdictions. The alternative of the separate accounting method is the exception which

is rarely and only in special circumstances applied by states generally. In addressing Butler Bros. v. McColgan, 315 U.S. 501 (1942), (also cited with favor by this Court in Mobil, supra 18), "(this) holding must be read as a conclusion that separate accounting is inherently incapable of impeaching an apportionment formula." W. Beaman, Paying Taxes to Other States s. 3.18 (1963) While this statement might be viewed as an overly broad conclusion in cases of gross distortion, Hans Rees' Sons, Inc. v. North Carolina, 283 U.S. 123 (1931), it highlights the comparative weaknesses of the separate accounting method. A more definitive analysis of the weaknesses of separate accounting and its lack of ability to impeach apportionment is contained at J. Hellerstein, State Taxation, 8.10[2] and 8.10[3], (1983).

Shell's Hybrid Separate Accounting Method

Under both an apportionment or a separate accounting method it is necessary that a profit and loss statement consisting of gross income, attributable expenses, and net income must be contemplated. Those states which apportion federal taxable income as explained above use federally determined gross receipts as the measure of gross income.

While the concept of "realization" is a concept underlying determination of gross income, that concept is rationally related to construction of the sales fraction used by states for apportionment purposes.

> The terminology varies; [Uniform Division of Income for Tax Purposes Act] UDITPA and some non-UDITPA state statutes use the term "sales factor", and other states use the term "gross sales" ....
>
> The inept term "sales factor" may have been adopted because the three factor formula had its origin in, and was designed for,

> mercantile and manufacturing companies. Other States use the more appropriate term "receipts" to cover the factor.
>
> The receipts factor is usually coterminus with the apportionable receipts.

J. Hellerstein, State Taxation, 9.17 (1983).

Thus, the sales factor (gross receipts) for apportionment purposes is equated with the same receipts which comprise "gross income". Logic alone demands that a concept underlying one is similarly applicable to support the other, absent a clear statutory expression to the contrary. Common construction for both income determination affords complete symmetry and thereby minimizes distortion in result.

Generally as to attributable expenses states accept the Congressionally designed attribution rules contained in the I.R.C. and by

apportionment give them geographic situs. Most frequently the two step process above is constructively achieved with mathematical perfection by applying the apportionment factor directly to federal taxable income in a single calculation.

For a full exposition of Shell's hybrid separate accounting method, Florida addresses each of the two steps in the fundamental process of division separately as follows:

1. Gross Receipts

Shell computes its gross income (receipts) by multiplying the number of units produced times the market value at the wellhead thus using a valuation not derived from actual federal gross income (receipts) determined in respect of subsequent specific sales. Shell admits that it cannot match units of production with its actual sales of the units sold.

(Appellant's Br. 8). Shell attempts to correlate its concept of gross income to federal gross income by subjectively concluding that all considered units of production ultimately and precisely become components wholly within that federal determination and are uniformly and geographically a ratable part of any included federal gross receipt, this despite Shell's admission of its inability to trace.

Generally business activities of production precede those of sales. Where production occurs in a taxable period which precedes the period of sale, the same block of general gross receipts is not addressed and Shell's method does not accommodate this timing difference.

Moreover, under state apportionment, the assignment of gross receipts for purposes of the sales fraction is made based on the situs of the sale and not

the situs of production. This is wholly consistent with federal concepts.[11] Under Shell's hybrid separate accounting method for oil production on the OCS the gross income (receipts) would be sitused at the place of production rather than

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[11] The case of a foreign entity provides insight as to assigning geographic situs to income for tax purposes. A foreign entity is subject to federal jurisdiction based on situs of the business activity of consummation of the sale.

> (4) Under 199(a)(6) and (e) of the 1939 Code, a nonresident alien engaged in business here derives income from the sale of personal property in the country in which [the goods are] sold.

United States v. Balanovski, 236 F.2d 298, 304 (2d Cir 1956). Thus, under the IRC the consummation of a sale provides a situs for geographic assignment.

States use sales similarly in whole or in part to assign increments of income.

> The gross receipts or sales factor, as it has developed with the general use of the sales destination test, is

the place of sale. Since the place of production usually corresponds with the place of the preponderance of the property and payroll, this shift of the gross income (receipts) to the situs of production is a redundancy of any property or payroll factor. Shell's shift of gross receipts to the OCS thereby denies the existence of any contribution to value attributable to the market place via a sales fraction.

2. Attribution of Expenses

An inherent weakness of separate accounting is a determination of fair attribution of expenses. Not only is

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> designed to give weight in the apportionment to the States in which the taxpayer markets its goods.
>
> * * *
>
> The sales destination rule finds support both in fiscal policy and in the ease and convenience of compliance and administration.

J. Hellerstein, State Taxation, 336 (1983).

this inherent weakness present in Shell's hybrid separate accounting method but also Shell has not clearly defined the principles it uses in segregating related expenses. In sharp contrast, state apportionment embraces the attribution rules of the I.R.C. Moreover, the weaknesses of Shell's concept of gross income as stated above are similarly apparent in any attribution of expenses.

3. Unitary Business Concept

While conceding the unitary nature of its business operations, Shell's attempt at separate accounting is inimical to the fundamental principles which underly the unitary business concept. Container Corp. of America v. Franchise Tax Board, 463 U.S. 159, 181 (1983).

Shell's Misapprehended Conclusion

Shell erroneously concludes that Louisiana was at the time of enactment of

OCSLA using apportionment to determine the instate income tax base of all multijurisdictional oil producers without exception. Actually, Louisiana then (as now) used two alternative methods to determine instate income of multijurisdictional oil producers, depending on whether the oil producer had an instate refinery. For oil producers with instate refineries (as is the case with Shell), apportionment was used to assign respective portions of the entire federal taxable income of the taxpayer. The existence of the tremendous amounts of refinery payroll and property instate which is reflected in Louisiana's three-factor formula substantially advantaged Louisiana revenues.

However, unquestionably the great preponderance of oil producers operating wells within Louisiana lacked instate refineries. Under the tax administrator's application as manifested

in The Texas Company v. Cooper, 107 So.2d 676 (1958), which addresses the tax years 1950, 1951 and 1952, oil producers which lacked instate refineries were required to determine the Louisiana portion of considered net income by a separate accounting method which embraced the use of artificial posted (market) prices at the wellhead. As to this latter group of group of oil producers, Louisiana again advantaged its revenues by separate accounting.[12]

Florida respectfully submits that Senator Long's comments were founded on his complete understanding of the Louisiana tax scheme, and were unquestionably aimed at extending full state tax jurisdiction to include the

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12 See criticism of Texas Company v. Cooper in J. Hellerstein, State Taxation, 8.11[5], (1983).

OCS. Applying OCSLA's conceded preemption to the Louisiana administrative practice manifested in Texas Company, Louisiana revenues were disadvantaged by assignment of income to wellheads located on the OCS rather than by sales which occurred on the mainland.

To the extent that the Congressional rejection of Senator Long's urgings may be construed as a rejection of a state tax method, the method rejected must be the Louisiana separate accounting method which was using artificial posted (market) prices at the wellhead as now Shell asserts before this Court.

The OCSLA does not dictate the tax accounting method required to accomplish recognition by the states of the existence or deference to the exclusive federal enclave. Rather, the apportionment process is clearly to be preferred over Shell's hybrid separate

accounting method to achieve OCSLA's purposes.

To the extent that apportionment is deemed state tax law, it is not visiting state taxation upon the OCS but is used by the taxing states to avoid state intrusion on the OCS.

Moreover, as Shell concedes, "to fill the substantial gaps" in coverage of federal law, OCSLA borrows "applicable and not inconsistent" laws of the adjacent states as surrogate federal law. "Gulf Offshore, 453 U.S. at 480 ....", (Appellant's Br. 4).

Application of apportionment is not inconsistent with the purpose of treating the OCS as an exclusive federal enclave. It is merely the means used by apportioning states to fairly achieve the required carve-out of the increments of federal taxable income deemed realized on the OCS.

Both Iowa and Florida, in laying their respective state income taxes on Shell were exquisitely aware of and respected the existence of an exclusive federal jurisdiction. States recognized that the constitutional standards used to limit assignment of values geographically were derived from decisions of this Court in defining constitutional parameters. These standards must have been visible to and considered by the Congress in the enactment of OCSLA and were deemed adequate to effect the purpose of OCSLA in limiting state jurisdiction geographically.

Other Shell Misapplications

Shell extolls the non-controverted power of the Congress to preempt certain state taxation without delineating the precise measure of the exercise of that power. The state position is that the tax method used here apportions income to

jurisdictions in which the business activities occur . The parameters of the various states are those conceded by the Congress to be within state jurisdiction in the Submerged Lands Act, 43 U.S.C. s. 1301-1315.

This Court has distinguished an income tax from a property tax.[13] Shell fails to do likewise in citing a number of decisions which address the Federal Public Debt Statute, 31 U.S.C. s. 3124, and its grant of total immunity from property taxation. Shell fails to identify the existence of the exception contained therein whereby states are permitted to levy a franchise or another non-property tax measured by net income on corporations. The decisions Shell cites are merely examples of imperfection

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13 Container Corp. of America v. Franchise Tax Bd., 463 U.S. 159, 188 (1983).

in the respective states' attempt to either fit within that statutory exception or circumvent application of the statute. Shell does not cite the plethora of decisions arising over more than a century culminating in two very recent decisions of this Court[14] in which states were successful in laying a tax within the exception. Moreover, in addressing the 1959 amendments, this Court concluded that Congress had thereby codified this Court's previously enunciated constitutional standards. Shell deems a parallel conclusion in respect of OCSLA as superfluous. (Appellant's Br. 42)

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14 Garfield Trust Co. v. Director Div. of Taxation, __ U.S. __; 107 S.Ct. 390 (1986), dismissing for want of a substantial federal question, 508 A.2d 1104 (N.J. 1986). First Union Natinal Bank of Florida, et al. v. Florida Department of Revenue __ U.S. __ (1988), dismissing for want of a substantial federal question. Department of Revenue, etc. et al. v. First Union National Bank of Florida, etc., et al., 513 So.2d 114 (Fla. 1987).

Furthermore, Shell cites First Federal Savings & Loan v. Dept. of Revenue, 200 Mont. 358, 654 P.2d 496, cert denied, 462 U.S. 1144 (1983), in which the Supreme Court of Montana struck down the Montana tax as violative of the Federal Public Debt Statute, but Shell fails to note that the Supreme Court of Montana flatly reversed its position in Schwinden V. Burlington Nothern, 691 P.2d 1351 (Mont. 1984). Shell's failure to notify this Court of Schwinden v. Burlington and Texas Company v. Cooper, can only cause confusion. Similarly, Shell's failure to identify the tax, the taxable event, and the precise extent of any other proscription in its citations of cases and statutes, particularly where that identification is not rationally related to the geographic limitation of state jurisdiction here, renders the citations non sequitors.

Finally, Shell urges that, as a minimum, OCSLA prohibits state taxation of "... Income Earned From Sales to Third Parties on the Shelf ..." (Appellant's Br. 44). However, Shell admits that Florida conceded it would do so as to sales consummated on the OCS and the denominator effect of the Iowa aportionment factor demonstrates that Iowa does likewise. Hence, Shell's assertion addresses a non-issue.

Conclusion

The United States declared that it has no substantial interest in this controversy. (86-1593 U.S. Br. 16) Moreover, the United States considers the respective Supreme Court decisions of both Iowa (U.S. Br. 6) and Florida (86-1593 U.S. Br. 6) correct and in no manner conflict with the provisions of OCSLA. For these reasons and those contained in this brief, Florida respectfully urges

this Court to affirm. Moreover, Florida urges this Court to dismiss Shell v. Florida.

Respectfully submitted,

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No. 87-984

In The
Supreme Court of the United States
October Term, 1987

SHELL OIL COMPANY,
Appellant,
v.
THE IOWA DEPARTMENT OF REVENUE,
Appellee.

ON APPEAL FROM THE SUPREME COURT OF IOWA

BRIEF OF AMICI CURIAE IN SUPPORT OF THE APPELLEE BY THE STATE OF NEW JERSEY AND THE STATES OF ARIZONA, ARKANSAS, COLORADO, IDAHO, MARYLAND, MINNESOTA, MISSOURI, MONTANA, NEW YORK, NORTH DAKOTA, OREGON AND SOUTH CAROLINA

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INTEREST OF AMICI CURIAE

Two concerns prompt this brief on behalf of *amici curiae*, the States of Arizona, Arkansas, Colorado, Idaho, Maryland, Minnesota, Missouri, Montana, New Jersey, New York, North Dakota, Oregon and South Carolina. All impose either a corporate franchise tax measured by net income or a corporate net income tax, and all use formulary apportionment to determine the portion of entire net income derived from sources within the taxing state.* Acceptance of Shell's position would seriously erode the unitary business principle, which underlies and justifies formulary apportionment. The keystone of Shell's argument is that the net income of a unitary business can be sourced to specific sites, *e.g.*, the Outer Continental Shelf ("OCS"). The idea that the net income of a unitary business can be sourced to particular geographic locales was rejected by this Court in *Mobil Oil Corp. v. Commissioner of Taxes*, 445 *U.S.* 425 (1980), and in *Exxon Corp. v. Wisconsin Dept. of Revenue*, 447 *U.S.* 207 (1980), and, having reappeared chameleon fashion here, should be rejected again.**

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* *Amici* other than Arizona, Idaho, Minnesota, New York and North Dakota determine apportioned net income using the net income and apportionment factors of the single corporate taxpayer doing business within the taxing state. Arizona, Idaho, Minnesota, New York and North Dakota use combined reporting which measures apportioned net income by taking into account the income and apportionment factors of a unitary group of corporations. *See Container Corp. v. Franchise Tax Bd.*, 463 *U.S.* 159 (1983). This distinction is not material here because the income in question is includable in the income base under both measurements.

** New Jersey has a particular interest in the case because it is the respondent in *Amerada Hess Corp. v. Director, Divi-*

(Continued on following page)

The other concern prompting *amici* to file this brief is that all of them, like Iowa, include in their respective net income bases income which Shell claims is earned on the OCS. All *amici* are thus concerned with the precise legal issue presented, the potential revenue loss, and the difficult questions of proof and computation inherent in Shell's position.

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ARGUMENT

THE OUTER CONTINENTAL SHELF LANDS ACT DOES NOT PREEMPT THE STATE OF IOWA FROM IMPOSING ITS CORPORATE NET INCOME TAX ON THE APPORTIONED NET INCOME OF A UNITARY BUSINESS, INCLUDING INCOME ALLEGEDLY EARNED ON THE OUTER CONTINENTAL SHELF.

This is a preemption case. Thus the primary question is whether Congress, in enacting the Outer Continental Shelf Lands Act, (43 *U.S.C.* sections 1331 *et seq.* ("OCSLA")), intended to preclude Iowa from imposing its corporate net income tax on an apportioned share of Shell's net income when there has been no exclusion of income allegedly derived from the OCS. *See Shaw v. Delta Air Lines, Inc.*, 463 *U.S.* 85, 95 (1983); *Fidelity Federal*

(Continued from previous page)

sion of Taxation, No. 87-453 and *Texaco Inc. and Tenneco Oil Co. v. Director, Division of Taxation*, No. 87-464, probable jurisdiction noted 56 *U.S.L.W.* 3781 (May 16, 1988), which, like this case, involve the computation of the net income base of a unitary business. In joining in this brief, the other *amici* do not necessarily subscribe to New Jersey's position in Nos. 87-453 and 87-464.

Sav. & Loan Ass'n v. De La Cuesta, 458 *U.S.* 141, 152 (1982). In a review of a preemption challenge, state legislation is presumed valid; preemption is disfavored and is to be found only in the clearest cases of conflict. *Chicago & North Western Transportation Co. v. Kalo Brick & Tile Co.*, 450 *U.S.* 311, 317 (1981); *Maryland v. Louisiana*, 451 *U.S.* 725, 746-47 (1981). This presumption in favor of state legislation is particularly strong where a State is exercising a traditional function of its sovereignty, *e.g.*, taxation. *Metropolitan Life Ins. Co. v. Massachusetts*, 471 *U.S.* 724, 740 (1985); *Jones v. Rath Packing Co.*, 430 *U.S.* 519, 525 (1977).

Congressional intent to displace state law can be either express (*see e.g. Aloha Air Lines, Inc. v. Director of Taxation*, 464 *U.S.* 7 (1983); *Exxon Corp. v. Hunt*, 475 *U.S.* 355 (1986)) or implied. *Metropolitan Life Ins. Co. v. Massachusetts, supra* at 738. Implied preemption can be inferred from the pervasiveness of federal legislation which leaves no room for state intrusion, by the predominance of the federal interest in a particular field, by the objective of federal legislation, or the inconsistency of state legislation with a federal objective. *Rice v. Santa Fe Elevator Corp.*, 331 *U.S.* 218, 230 (1947); *Maryland v. Louisiana, supra*, at 746-47.

Since Shell asserts that the plain language of OCSLA prohibits imposition of the Iowa tax, *i.e.* that this is a case of express preemption, the starting point for the preemption analysis is the language of the federal statute. *See Exxon Corp. v. Hunt, supra* at 362. The language of OCSLA does not support Shell's argument.

Shell points to two provisions—section 1333(a)(2)(A), which provides in part that "State taxation laws shall

not apply to the outer Continental Shelf" and section 1333(a)(3), which provides in part that OCSLA "shall never be interpreted as a basis" for a State to claim "any interest in or jurisdiction . . . over the seabed and subsoil of the outer Continental Shelf . . . or the revenues therefrom." Even when this language is considered in a vacuum without reference to its context or legislative history, it does not have the meaning Shell advances.* Iowa is neither applying its corporate income tax to the OCS nor laying claim to an "interest in . . . revenues" from the OCS. Shell's argument to the contrary (*cf.* Shell b26) reflects a basic misunderstanding of what OCSLA intended and of the operation of the Iowa income tax. Iowa is not, and could not under the Due Process Clause, extend its income tax law to the OCS because the OCS is plainly not within the geographical boundaries and thus the political jurisdiction of Iowa. Iowa is confined to

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* Shell attempts to set the stage for its argument by reviewing a multitude of unrelated federal statutes containing various state tax preclusions (Shell b18). One need not quarrel with Shell's statement that Congress has the power to limit state taxation to nevertheless conclude that none of the cited statutes, with their varying preemption language, suggests the proper construction of OCSLA. To take 31 *U.S.C.* sec. 3124(a) as an example, it is clear that (1) Congress intended in section 3124 to create a tax exemption for stocks and obligations of the United States, (2) Congress specified the precise scope of the exemption, extending it to "each form of taxation that would require the obligation, the interest on the obligation, or both, to be considered in computing a tax," and (3) having been specific in creating the exemption, Congress was explicit in validating two types of state taxation-nondiscriminatory franchise taxes, and estate or inheritance taxes. Section 1333(a) of OCSLA does not state that it is creating a tax exemption but rather that state taxation laws shall not apply to the OCS, and, being directed at state tax laws, not subjects exempt from state taxes, neither details particular types of preempted state taxes nor validates certain others.

taxing the in-state attributes of a unitary business. Those in-state values are determined by applying an apportionment factor to the net income of a unitary business. Assuming for the sake of argument that it could be demonstrated with certainty that Shell's net income included net income earned on the OCS,* the effect of the Iowa apportionment formula is to eliminate such income from the base. The Iowa apportionment factor is the ratio of Iowa sales to total sales, and in most other States the factor is the ratio of in-state sales, wages, and property to total sales, wages, and property. Included in the denominator of the sales fraction are those sales made by Shell on the OCS. Since there are no OCS sales in the numerator of the sales fraction nor any demonstrable OCS value in the numerator,** the effect of including those sales in the denominator is to remove OCS sales from the tax base or more precisely to remove a corresponding portion of net income from the tax base. Far from applying its tax law to the OCS, by means of its apportionment formula Iowa has eliminated any such extraterritorial extension of its income tax.***

Nor is Iowa asserting an interest in "revenues" from the OCS. Again, consistent with the Due Process Clause, Iowa could not, at least on an unapportioned basis, tax

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* As discussed below, it cannot be demonstrated what, if any, portion of Shell's net income was earned on the OCS.

** Shell has conceded that there is no way of determining "with any degree of certainty" whether its Iowa sales included crude oil having its ultimate source on the OCS (J.A.19).

*** The inclusion of OCS sales in the denominator of the apportionment factor is plainly not an extension of Iowa's taxing power to the Shelf. *See Maxwell v. Bugbee*, 250 *U.S.* 525, 539 (1919).

revenues from sales of natural gas and oil made on the OCS because the OCS is not within the territorial jurisdiction of Iowa. But Iowa is not taxing revenues; it is taxing net income apportioned to Iowa. The stumbling block of separate accounting and the rationale for the unitary business principle is that in the case of a unitary business it is impossible to determine the precise geographical sources of a company's net income. *Mobil Oil Corp. v. Commissioner of Taxes, supra* at 438. Since a company's net income derives "from the operation of the business as a whole, it becomes misleading to characterize the income of the business as having a single identifiable 'source.'" *Ibid; and see Exxon Corp. v. Wisconsin Dept. of Revenue, supra* at 226, (rejecting Exxon's argument that income allegedly earned outside Wisconsin from the production of crude oil and natural gas should be deducted from the Wisconsin net income base).* Shell's attempt to isolate net income attributable to the OCS (J.A. 36 to 43) is to no avail because "the profit figures relied on by [Shell] are based on precisely the sort of formal geographic accounting whose basic theoretical weaknesses justify resort to formula apportionment in the first place." *Container Corp. v. Franchise Tax Board,* 463 *U.S.* 159, 181 (1983). To take a single example, the expenses listed at J.A. 40 for exploration, land expense, research, and head office are prorated by Shell to the OCS. There is no assurance that such proration takes into account the true transfers of value between Shell's two operating segments—its Products Organization and its E & P Organization. These difficulties in isolating net income actually atributable to the OCS exist whether revenue is generated by a sale on the OCS or by a sale elsewhere. In either case it is impossible to determine what, if any, portion of OCS revenue or value ends up in net income. The contributions to net income from refining, manufacturing, and selling in the continental United States may far exceed the contribution to net income from sales or value on the OCS. *See Moorman Manufacturing Co. v. Bair,* 437 *U.S.* 267, 276 (1978).

* In *Exxon,* as here, there were two types of purported "situs" income—income attributable to the wellhead value of crude oil transferred downstream from Exxon's Exploration and Production Department to its Refining Department and income attributable to third party sales at the wellhead. 447 *U.S.* at 217. The Court did not reach the issue of wellhead sales because Wisconsin took the position that under its statute the income from such sales was excludable. 447 *U.S.* at 226 and n.10.

Shell argues (Shell b21) that there is no difference in "economic substance" between a single state tax on 100% of Shell's apportioned OCS income and state taxes levied directly on OCS production. To the contrary, if as Shell hypothesizes, it did business only in Iowa and on the OCS, the economic sources of Shell's net income would be entirely within Iowa except for its crude oil production on the Shelf. Under those circumstances, absent a showing of an egregiously excessive tax burden, Iowa could properly tax 100% of Shell's net income because it would be imposing its net income tax on the Iowa incidents of a unitary business. *See Moorman Manufacturing Co. v. Bair, supra.* That would not be the case, assuming again that Shell did business only in Iowa and on the OCS, were Iowa to impose its net income tax on a separate accounting basis on the entire value of Shell's crude oil production on the Shelf. The tax would not be related to the economic sources in Iowa of Shell's income but rather to Shell's

economic activities on the Shelf. Thus, in economic terms, the two impositions would be quite different, both in concept and amount.

When the language Shell points to is considered in its statutory context, as indeed it must be (*Richards v. United States*, 369 *U.S.* 1, 11 (1962)), Shell's argument collapses altogether. The language as to non-applicability of state taxation laws is the last sentence of section 1333(a)(2)(A). The preceding sentences of that section declare the civil and criminal law of *each adjacent* State to be the law of the United States for the portion of the OCS which would be within such State if its boundaries were extended seaward. This declaration capsulizes a significant congressional compromise between senators, including Senator Long, who advocated that the laws of the adjacent States should govern the administration of the OCS (*see Rodrigue v. Aetna Casualty & Surety Co.*, 395 *U.S.* 352, 358-59 (1969)), and those who maintained that federal maritime or admiralty law should apply (*Id.* at 361-65). The compromise set forth in section 1333(a)(2)(A) is that federal law applies to the OCS, but the law of the adjacent States is adopted as federal law. Behind the decision to use state law as federal law were the competing concerns that workers on OCS platforms were closely tied to the adjacent States but that state law and state political jurisdiction could not or should not be extended to those structures. *Id.* at 363-64.

The final sentence in section 1333(a)(2)(A) that "State taxation laws shall not apply to the outer Continental Shelf," viewed in context, is a natural sequel to the ideas expressed in the first part of the section. The incorporation of adjacent state law as federal law raised the

question of the applicability of the taxation laws of the adjacent States, and, making explicit the views of the Justice Department that state law and political jurisdiction could not and should not be extended to the OCS (*Id.* at 364), Congress included the quoted language. Thus, viewed in context, the obvious meaning of the sentence "State taxation laws shall not apply to the outer Continental Shelf" is to exclude the tax laws of both the adjacent and inland States from those state laws adopted as surrogate federal law.

Viewed in context, the language in section 1333(a)(3) (the other provision on which Shell relies) that OCSLA "shall never be interpreted as a basis" for a State to claim "any interest in or jurisdiction . . . over the seabed and subsoil of the outer Continental Shelf . . . or the revenues therefrom," is equally contrary to Shell's position. In *Gulf Offshore Co. v. Mobil Oil Corp.*, 453 *U.S.* 473 (1981), this Court held that despite OCSLA's declaring the OCS to be an area of exclusive federal jurisdiction, state courts are not deprived of concurrent jurisdiction in those cases where state law has been declared surrogate federal law by section 1333(a)(2)(A). Relying, as does Shell, on section 1333(a)(3), the petitioner in *Gulf* argued that state court jurisdiction over a personal injury case would contravene the mandate that OCSLA "shall never be interpreted as a basis for claiming *any . . . jurisdiction* on behalf of *any state* for *any purpose* over the . . . outer Continental Shelf. . . ." (emphasis added). This Court replied:

> This argument again confuses the political jurisdiction of a State with its judicial jurisdiction. Section 1333(a)(3) speaks to the geographic boundaries of

> state sovereignty, because Congress primarily was concerned in enacting OCSLA to assure federal control over the Shelf and its resources. [453 *U.S.* at 482].

Gulf thus stands for the general proposition that depite the comprehensive prohibition of state jurisdiction over the OCS in section 1333(a)(3) certain kinds of non-political state jurisdiction remain unaffected. The thrust of section 1333(a)(3) is simply to set "the geographical boundaries of state sovereignty." State action which does not extend state boundaries into the OCS is not foreclosed. The additional phrase in section 1333(a)(3) that no State may claim "any interest in . . . the revenues" from the OCS is similarly directed at the territorial limitations on state sovereignty. As made clear in the Senate Report, the purpose of section 1333(a)(3) is to establish that the adoption of state law does not permit a State to participate "in the administration of or revenues from the areas *outside of State boundaries.*" *S. Rep. No.* 411, 83d Cong., 1st Sess. (1953), at 23 (hereinafter "Senate Report," emphasis added). Iowa's imposition of its corporate net income tax on the portion of Shell's net income derived from Iowa sources does not extend Iowa's boundaries or its political jurisdiction into the OCS. (If it were otherwise, no State could, consistent with the Due Process and Commerce Clause, impose its corporate net income tax on the apportioned entire net income of a unitary business.)

Gulf stands as well for the proposition that if a subject is not specifically mentioned in section 1333(a)(3) it is not beyond state jurisdiction.

> The language of [section 1333(a)(3)] refers to 'any interest in or jurisdiction over' real property, minerals and revenues, *not over causes of action.* . . . We do not think the legislative history of OCSLA can be read to rebut the presumption of concurrent state-court jurisdiction, given *Congress' silence on the subject in the statute itself.* [453 *U.S.* at 482-3 emphasis added].

Similarly here, OCSLA's silence regarding the imposition of an apportioned net income tax on net income derived from the Shelf should not rebut the presumption against preemption of state law.

OCSLA's legislative history, which Shell refers to at length (Shell b28 to 41), offers no more support to Shell than does the statute as enacted. The legislative history contains no direct reference to the adjustment Shell urges. Moreover, with the one exception discussed below, the numerous references in the legislative history to state taxation refer to the exercise of taxing jurisdiction by States adjacent to the OCS and to forms of taxation other than the corporate income tax. The single exception is the contention of Senator Long, an opponent of the legislation, that adjacent States would have costs as a result of the development of the OCS but no sources of revenue directly related to that development.. In enumerating the revenue sources which OCSLA foreclosed to Louisiana and the other adjacent States, Senator Long, in his Minority Report, included "the State's severance tax, property tax, [and] tax on corporate profits." *Senate Report* at 67. This single statement appears to be the only reference in the entire legislative history of OCSLA to corporate net income taxes. As such, it is no basis for in-

ferring the intent of Congress. As this Court recently stated in determining the effect of a single Senator's statement concerning the scope of the tax exemption found in section 5(e) of the National Housing Act of 1937:

> The relevant passage comes in the middle of a long speech, and no similar expression is to be found in any other legislative debate or document. This short isolated comment simply cannot overcome the understood meaning of section 5(e) and the presumption against implied tax exemptions. [*United States v. Wells Fargo Bank*, 56 *U.S.L.W.* 4265, 4267 (1988)].

Similarly here, Senator Long's isolated comment referring to Louisiana's tax on corporate profits cannot overcome the settled doctrine that the imposition of an apportioned net income tax does not extend a State's taxing jurisdiction beyond its borders.

Moreover, it is far from clear that Senator Long was thinking in terms of OCSLA's foreclosing the imposition of Louisiana's net income tax on an apportioned share of an integrated oil company's net income (*cf.* Shell b32). As made clear in *Texas Company v. Cooper*, 236 *La.* 380, 107 *So.*2d 676 (1958), while Louisiana had a corporate net income tax in the early 1950's which used formulary apportionment, the tax collector had the right to require separate accounting in cases where the apportionment method produced an unfair result:

> When the collector finds that use of the apportionment method by a taxpayer produces a manifestly unfair result and that the separate accounting method would more equitably determine the amount of net income derived from sources in Louisiana, he may require that the separate accounting method be used in such case. [236 *La.* at 390]

A regulation made clear that separate accounting could be required of oil companies engaged in the production of crude oil in Louisiana. *See* 236 *La.* at 409. In the *Texas Company* case, the Louisiana Supreme Court upheld the tax collector's determination that the oil company had to use separate accounting because formulary apportionment produced a manifestly unfair result. The Texas Company, although an integrated oil company, engaged only in the production, sale, and transportation of crude oil in Louisiana and had no refinery there. Separate accounting was appropriate, according to the court, because the production of crude oil in Louisiana was a discrete and easily quantifiable step. 236 *La.* at 399. In light of its statutory authority, its regulation, and the *Texas Company* case, had OCSLA permitted Louisiana to extend its taxation laws to the OCS, it is quite likely that Louisiana would have required separate accounting for production on the Shelf. Given Senator Long's views that Louisiana's severance and property taxes should have been applicable to the OCS (*Senate Report* at 67), it is entirely plausible that in referring to the State's tax on corporate profits, the Senator had in mind the application of separate accounting to production on the OCS. That, of course, is not what Iowa has done in taxing Shell.

Finally, the imposition of Iowa's apportioned net income tax with respect to Shell's activities in Iowa does not thwart the federal policies fostered by OCSLA, whether the original 1953 version or the 1978 amendments. Shell's suggestion to the contrary notwithstanding (Shell b35), "The legislative record suggests that maximization of economic returns was not the driving force behind the legislation." (Brief for the United States as *amicus curiae*

in *Shell Oil Co. v. Florida,* No. 86-1593). Rather, the federal policies sought to be accomplished by OCSLA were the establishment of "exclusive jurisdiction and control of the Federal Government of the United States over the seabed and subsoil of the outer Continental Shelf and the development of its vast mineral resources." *Senate Report* at 2, quoted in *Gulf Offshore Co. v. Mobil Oil Corp., supra* at 479, n.7. Iowa's imposition of its corporate net income tax on an apportioned share of Shell's net income, some of which may derive from the OCS does not in any way frustrate the exercise of federal jurisdiction and control over the OCS nor the development of the Shelf's resources. Iowa's tax in no way extends into the OCS nor reaches OCS development *per se.* The burden of the tax is simply too remote from the OCS to thwart OCSLA's policies.

In summary, neither OCSLA itself, nor its legislative history, nor the policies it promotes suggests that Congress intended to preempt the imposition of Iowa's apportioned net income tax with respect to Shell's activities in Iowa. Iowa is not extending its tax laws to the OCS nor is it claiming an interest in OCS revenues. Rather, it is subjecting to tax the Iowa incidents of Shell's unitary business. The tax base is net income apportioned to Iowa, and whether that net income base contains income earned on the OCS cannot be determined on this record. Even if that fact could be determined, Iowa's tax would still not violate OCSLA because it would remain a tax on the Iowa portion of Shell's net income, and there would still be no extraterritorial extension of Iowa's tax laws into the OCS.

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CONCLUSION

For the reasons stated above, the judgment of the Supreme Court of Iowa should be affirmed.

Respectfully submitted,

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